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FRAUD AND ABUSE IN COMMUNITY SERVICES ADMINISTRATION

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HEARING
BEFORE THE
SUBCOMMITTEE ON FEDERAL SPENDING
PRACTICES AND OPEN GOVERNMENT
OF THE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NINETY-SIXTH CONGRESS

SECOND SESSION

JUNE 5, 1980

PART 2

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FRAUD AND ABUSE IN COMMUNITY SERVICES ADMINISTRATION

THURSDAY, JUNE 5, 1980

**U.S. SENATE,
SUBCOMMITTEE ON FEDERAL SPENDING
PRACTICES AND OPEN GOVERNMENT,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.**

The subcommittee met at 10:20 a.m., in room 3302, Dirksen Senate Office Building, Hon. Lawton Chiles (chairman of the subcommittee) presiding.

Present: Senator Chiles.

OPENING STATEMENT OF SENATOR CHILES

Senator CHILES. Today's hearing marks another attempt by the Subcommittee on Federal Spending Practices and Open Government to determine how thousands of Community Service Agencies are spending millions of tax dollars each year. Perhaps I should say misspending tax dollars because other hearings we have held on the subject have turned up many cases of misspending and outright fraud.

Today's hearing won't be too different from previous hearings. In our previous hearings we tried to determine problems in the local agencies, but as the Government took steps to stop fraud and abuse of tax dollars in those agencies, we found even more cases of the same.

In one example we will hear of today, the head of a local Community Service Agency in California embezzled money from one Federal account to pay his income tax bill. This case is a good example of why the single audit concept should be implemented at the Federal Government.

To make matters worse, when he began to fear that the auditor of that Federal fund might catch him, he embezzled money from another program to pay back the original account. One might wonder whether he really stole any money or not from the Government because he used it to pay his income taxes.

The way things operate now, an auditor of one Federal fund merely tracks the money from his department. He doesn't care what happens to other Federal moneys which are coming into the local account.

A single audit representing all the Federal departments funding a local agency would, however, be responsible for the total expenditure. Certainly that has to create better control over expenditures.

We have heard a lot of favorable comments about the single audit concept at one of our earlier hearings, but officially Washington still has not taken steps to implement the program.

The General Accounting Office will report to us today that the abuse and misuse of Federal funds at local agencies will continue to occur and may even become more prevalent, unless the Federal grantmaking agencies will either revise or enforce financial management policies and procedures to gain more effective control over the use of Federal funds.

I am in total agreement with what we will learn today about the steps which are being taken to gain better control over expenditures, thereby saving tax dollars and insuring that we are helping those who actually need the help.

Our first witness today is going to be Dr. John White, the Deputy Director of the Office of Management and Budget.

Dr. White, we are delighted to have you with us today. You can proceed with your statement, sir.

TESTIMONY OF JOHN P. WHITE, DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY JOHN LORDAN

Mr. WHITE. Thank you, Mr. Chairman. It is a pleasure to be here. We welcome the opportunity, as you know, to discuss with you the question of grant auditing and the administration's efforts to deal with the problems of fraud, waste, and error in federally assisted programs.

In fiscal 1980, Federal aid will amount to almost \$90 billion, of which about \$34 billion will go to State and local governments. The remainder will go to universities, hospitals, and nonprofit organizations. Grant programs are carried out by practically every department and major agency of the Federal Government and affect virtually every segment of our society. With so much of the Federal tax dollar being spent by non-Federal organizations, the need for accountability and audit becomes critically important.

This administration is deeply committed to making Government more accountable. We have moved on every front to eliminate fraud, abuse and waste and to bring strong management control to Government. We view effective audit as an indispensable tool in building a more efficient Government.

President Carter, in his first year in office, called upon the heads of departments and agencies to improve their audit systems, particularly as they relate to grant programs. He urged them to upgrade audit planning and to—

Use their audit plans as a basis for making greater efforts to improve interagency cooperation on audits, to increase Federal coordination with State and local auditors, and to increase reliance on audits made by others.

Turning to the single audit concept, last October, after 2 years of study and consultation, OMB revised the audit rules in circular A-102, "Uniform Requirements for Grants to State and Local Governments."

The circular made it clear that recipients of Federal aid are responsible for a basic audit of programs they carry out and that Federal audits should build upon audit work already done at the recipient level.

This approach has been called the single audit concept because it gets away from grant-by-grant audits and moves toward audits of an organization as a whole. The single audit concept had been urged by the General Accounting Office, the joint financial management improvement program, and State and local officials.

The revised circular said OMB should do three things:

First, work with GAO on revisions to a standard audit guide that would replace almost 100 individual program guides.

Second, publish a cognizance list, naming one Federal agency to act for all in assuring that proper audits are made of State and local agencies.

And third, publish a compliance supplement that would summarize the major audit compliance features of big Federal aid programs.

Here is what we have done:

The GAO standard audit guide has been revised and reissued. It was cosigned by the Comptroller General and the Director of OMB.

A cognizance list has been published for comment containing over 800 State agencies that are the major recipients of Federal aid. That list will be finalized in a few weeks.

We are about to issue the compliance supplement for 60 programs that make up over 90 percent of Federal aid. This has been developed cooperatively with the agencies and with advice from State and local auditors. We hope this, too, will be cosigned by the Director and the Comptroller General.

We have underway a number of monitored audits that use the single audit approach. We will be reviewing the results of these audits.

Finally, we intend to extend this concept shortly to other types of grantees such as Community Action agencies, Indian Tribes, and Councils of Government.

I might at this point, Mr. Chairman, add that although we have not formally extended this concept beyond the State and local Governments, we do intend to do that. We urged CSA to extend the concept to their recipients. We are working with them and other agencies in order to do this.

We believe these changes represent a fundamental reform of the grant auditing process. We recognize that reform takes time and that many details will have to be worked out as we go along.

In addition to grant audit reform, we have taken a number of related steps to improve accountability in Government programs. These initiatives involve the Inspectors General, the Executive Group To Combat Fraud and Waste, and the financial priorities program. Let me give you some brief illustrations.

For example, enactment of the Inspector General Act provided a major opportunity for the President to address the issue of fraud and waste directly. The President was determined to make the Inspector General legislation a success. He took a number of steps designed to emphasize his continued support of Government-wide efforts to combat fraud and waste and improve government.

In December 1978 he communicated to the heads of all departments and agencies saying,

Today I am directing that significant features of the Inspector General program be extended throughout the Federal Government. Eliminating waste, fraud and error should be as important to you as your program objectives.

In May 1979 he created the Executive Group To Combat Fraud and Waste in Government.

The Executive Group To Combat Fraud and Waste is an inter-agency mechanism designed to marshal governmentwide support for the Inspector General program and other efforts to combat fraud and waste. The Deputy Attorney General serves as chairman of the group and I serve as vice chairman. The group's membership includes all of the statutory Inspectors General, the Deputy Director of the Office of Personnel Management, and the Special Counsel of the Merit Systems Protection Board. The Federal Bureau of Investigation, Internal Revenue Service, and Postal Inspection Service are also represented.

In addition, last May we announced the launching of a financial priorities program aimed at resolving the major financial issues facing Government.

When this program began, agency financial systems had many weaknesses. There were reports of major breakdowns in fund control, with millions of dollars being overobligated. Audit reports citing billions of dollars in questioned costs were going unresolved, sometimes for years. Hundreds of millions in unspent grant funds were being retained by recipients. Cash management practices and debt collection practices were very poor.

This program is designed to direct top management attention to needed improvements in agency financial systems. The priorities were worked out by OMB in consultation with the Congress, the Comptroller General and the agencies. The priorities that were agreed to by this group were:

First, we have a goal of obtaining General Accounting Office approval of all accounting systems.

In addition, we are upgrading internal control systems to reduce the risk of fraud, abuse, waste, and inefficiency. In fact, last week we convened the first meeting of a new task force assembled for this purpose by the Director. We will be working on this project over the next 2 months.

In addition, we are continuing to emphasize good cash management practices that build upon the President's cash management project. It has already saved over \$1 billion a year.

We are stressing audit followup to make sure that audit findings are resolved quickly and properly.

We have been working hard with the agencies to improve our outlay estimating and think we are making some real progress.

We are placing major emphasis on debt collection, which is a major area of concern to us. For instance, we have found that there is over \$100 million in defaulted student loans.

We are emphasizing better auditing and accurate accounting and better procedures with respect to control of overtime.

The grant financing program will increase the use of letters-of-credit and electronic funds transfer and recovery of unspent funds.

We are also emphasizing grant accountability. This program seeks full implementation of standard administrative requirements and cost principles.

During the last few months, Mr. Chairman, the Comptroller General, Director McIntyre and I have met with Cabinet members and heads of major agencies to discuss this program. We have

obtained commitments from the agencies to move aggressively to correct deficiencies. In addition, the program has been fully integrated with our regular budget review process. We have used the entire resources of OMB to press the agencies for progress.

We believe all these efforts, taken together, represent an unprecedented commitment by this administration to accountability. But we know much remains to be done.

We expect to continue to work closely with the General Accounting Office on this as well as with the Executive Group To Combat Fraud and Waste, the Intergovernmental Audit Forums, and the joint financial management improvement program. We know that we can also count on the continued cooperation and support of this committee and other Members of the Congress.

We recognize that for many years, you, Senator Chiles, and this subcommittee have been in the forefront of efforts to improve accountability in Government. The administration is strongly committed to the same objective.

We hope to move forward with you in the future to see that needed improvements are put in place.

Thank you, Mr. Chairman.

Senator CHILES. Thank you, Dr. White.

As I read the attachment to circular A-102 and understood the application of audit requirements, it looks like it is going to take a long time to reach the grassroots level. What kind of timetable does OMB have for speeding up the process, and when will it be implemented?

Mr. WHITE. I would like to turn to my colleague, Mr. Lordan, on that, Mr. Chairman. But let me mention that we have two conflicting problems here. First of all, we are pushing very hard in this effort in order to not only get at the State and local governments but, as I indicated in the statement, to go beyond that; for instance, the Community Action agencies.

At the same time we recognize, as others have pointed out to us, that if we go too fast, we are in jeopardy of doing it incorrectly and putting the whole effort back a notch. So there is a problem of what is the appropriate speed here.

Let me ask Mr. Lordan to talk about the schedule that we are on.

Mr. LORDAN. Mr. Chairman, the provisions of the circular, of course, are in effect now. The agencies are in the process of implementation.

Much of the pace of implementation will be affected by the ability of State and local governments to respond, the ability of State and local audit organizations to pick up the responsibilities that are laid out for them in attachment P. We think that some States will be able to move on that very, very quickly. In others, it may take quite some time.

We are not in a position to predict the final date at which every State and local government will be able to meet its responsibilities, but we think as long as we work with the better ones—the ones who can move fastest—and let them set an example, we ought to have the process in place within the next year or so.

Senator CHILES. That gives me some concern because the better ones probably aren't where the fraud and abuse are.

It is often difficult to relate substandard work to an entire firm. You may have a national practice and poor performance in one case and quite adequate performance in other cases.

Senator CHILES. Well, in addition to that, is there any provision for taking off of the list, prohibiting future audits with public agencies, a discipline like that? Is that available?

Mr. LORDAN. Yes, Mr. Chairman; again, when the relationship is directly with the Federal Government. When we are contracting for the service, that type of identification of substandard firms can be made and a listing of those firms circulated to other agencies. It is more difficult to do that when we are dealing with thousands of local governments and State governments that may be engaging the firms.

I think the weight of public opinion is very important here. If documented cases of substandard performance can be lodged against a firm and that word is distributed to people, that certainly will have an impact on their practice and I think provide an incentive to look for solutions.

Senator CHILES. One of the big hangups in trying to get executive branch agencies to agree to a single audit system is the feeling among some agencies if they have a minor funding function in an agency, then the auditors won't take their program objectives into consideration. None of the agencies want to play a subordinate role. How do you deal with that?

Mr. WHITE. Mr. Chairman, as you know, with your experience, that is always true in the Federal Government. We have done that by getting the agencies to work with us in putting together these lists so that they will cooperate and also getting them the feedback in terms of what happens.

We will have to—and OMB takes a role in this—assure that all of the agencies, even those that are small, get appropriate recognition and concern for their part of the program. So it is largely an oversight function and keeping them involved.

Senator CHILES. The critical aspect of the implementation of either Circular A-102 or A-110 or any other OMB directive is how much direction follow-up they get from the administration. Is OMB prepared to vigorously enforce the single audit procedure?

Mr. WHITE. Yes, sir, we certainly are. Let me give you two elements of that. One element has to do with the active involvement—which we discussed just last week and I will have on the agenda the next time we meet—of the Fraud and Waste Committee so that we have the Inspectors General involved. The second one is that we have integrated these efforts into our budget process so that we, when we look at the budget process, take cognizance of what the agency is doing in these areas as well.

As you well know, that is our major leverage in terms of getting agency responses. So we have integrated it so that we do that.

One last comment. As I mentioned, the Director and I have met with the Cabinet heads and heads of the big agencies and stressed our priority in these areas and what priority the President gives to these areas. There again, once we have gotten their attention and they signal to their agencies this is something we are going to pay attention to, I think it makes a big difference.

Senator CHILES. The Executive Group To Combat Fraud and Waste's financial priorities program is a program adopted by that agency, and by that group?

Mr. WHITE. No, sir. The financial priorities program is an effort by OMB in cooperation with the General Accounting Office.

Senator CHILES. I see. That is not a part of the executive practices.

Mr. WHITE. No, it is not. But we have briefed the Fraud and Waste Committee on that program and we have involved them directly in aspects of it, like the single audit.

Senator CHILES. How often is the Fraud and Waste Committee meeting? What actually takes place at the meetings?

Mr. WHITE. We have been meeting recently I think, if I am correct, it is every 2 weeks and sometimes every month, but frequently.

We have a small core staff which the agencies, OMB and the Attorney General's office have contributed to. We have a regular agenda which initially was implementation oriented. We have now switched to a regular agenda which is problem oriented; what are the problems we are going to be dealing with.

We task the various Inspectors General in terms of committee assignments to deal with various aspects, like standards investigations, practical problems, their travel limitations and recruiting limitations, their relationship to the FBI, their involvement in terms of subpoenas.

So we have a regular agenda, chaired by Judge Renfrew, and we spend at least 1 or 1½ hours in every meeting working through that agenda.

Senator CHILES. As I understand it, the OMB Circular does require the grantees to return excess cash. That policy is reinforced by the 1978 memo to agency heads. Would you say the agencies have responded in a positive manner, and are they out there getting the excess funds back?

Mr. WHITE. I will have John answer that.

My impression is they are, but that is an area that needs more emphasis, as does the so-called debt collection in general. It is an area we are putting major emphasis on, but I think it is one, frankly, Mr. Chairman, that hasn't had the emphasis it needs.

Mr. LORDAN. Mr. Chairman, that is certainly the case. In connection with the grant financing elements of the program, agencies have reported to us that they have instituted programs for more rapid closeout of the grants, and the closeout is the point generally where the collection of cash takes place.

The Labor Department has a major task force on this now. We have received reports from them that they have collected some \$76 million either by direct payment to the Treasury or by offset against future grants, where small amounts of excess cash were being held by large numbers of individual grantees.

In addition, we have made a provision in Circular A-102 with regard to the issue of retainage, where a State government may be billing us on the basis of its cost but retaining from contractors cash which assures adequate performance of the contract. We have said that with respect to that practice, they will no longer be able to draw the Federal cash until they need it to pay the contractor.

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So there are a number of things underway, but as Dr. White points out, this is an area where substantial additional improvement is necessary.

Senator CHILES. It seems to me that this has to be one of the greatest problems we have. If you have excess cash, if it sits around for a long time, that has to be awful tempting.

Mr. LORDAN. Yes, sir.

Senator CHILES. When there is any kind of a shortage somewhere else or any kind of a problem or you need any kind of equipment, I am sure that temptation is very, very strong. "Well, here we are sitting and we have been holding all of this cash," and after a while it gets to be our money because it is there. And we have heard case after case where we see these local agencies treating this like their money after a period of time.

I think unless we can draw that in and make sure that we keep that down, you are going to continue to have problems. We are dealing with many people that in a lot of instances are kind of in the realm of their first experience in being managers, in dealing with cash, and I am sure there is just too much temptation there.

What can we do to speed this process?

Mr. LORDAN. Senator, there are certain things that OMB can do. We have tried to do those through the regulations that I referred to.

There is a need in the agencies to get much more aggressive in collecting these amounts of money and getting them back from the recipients. Increased use of the letters-of-credit will help in this regard. If the money isn't available until people need it to spend, they ought not to be holding those balances.

At this point the Treasury reports over \$100 billion a year in Federal aid is flowing through the letters-of-credit system. That is a very important control element that we have.

In the past, as you may know, funds were advanced to recipients. They were either advanced by Treasury check or by direct draw-down through the banking system. Through the use of the letters-of-credit method we have substantially better control I think than we had in the past.

As I indicated, the bulk of Federal aid now flows through that system. Now I think the framework is in place for the better management of cash, although there is a need for continued follow-up by the agencies to make sure these amounts are returned to the Treasury.

Senator CHILES. One of the great problems I see OMB having, and I know the Congress has it, and I guess the agencies, certainly the agencies themselves have it, is that we don't know how much cash is out there and we don't know who has the excess cash. How do we find that out so we can begin to pinpoint the areas and the agencies that aren't really doing the job there?

Mr. WHITE. I think it is fair to say, Mr. Chairman, that the audit efforts which we have been discussing and which we have been pushing help.

I think also, as I mentioned earlier, the audit followup, which ought not to even be a separate subject, which is really a critical part of the overall process, we are putting increased emphasis on the followup. As I think I indicated earlier, we have the problem of

finding the cash at the time of closeout. Those followups will make a difference.

Senator CHILES. What kind of incentive is necessary? Is an incentive necessary to require the agencies to do much more on the letters-of-credit?

Mr. WHITE. I will ask Mr. Lordan to respond.

My impression is we don't need a great deal more incentive there. We have displayed that the system works. We have gotten it widely adopted. I think it is just a question of continued attention.

Mr. LORDAN. I think that is correct.

Senator CHILES. You don't see any requirement from the appropriations language or anything?

Mr. WHITE. No, sir. I don't think we need it in this case. I think we have gotten a great deal of success out of it.

Senator CHILES. Can you tell me, are all of the agencies going in this direction or are there certain agencies that don't like the letters-of-credit and aren't using them? What is our experience?

Mr. LORDAN. Mr. Chairman, the only major Federal aid program that I am aware of that has restrictions on the use of the letter-of-credit is the Federal highway program. Their legislation calls for reimbursements to the State; that is, they must reimburse the State after it has incurred the cost. That prohibits their using the letter-of-credit. But in a sense that is an even more effective control.

Senator CHILES. You don't have excess balances that way. It is the State that has the problem.

Mr. LORDAN. That is correct; yes, sir. I think most other major Federal aid programs are now using the letter-of-credit and they are using it successfully.

The problem remains that some recipients take advantage of the system and draw an additional amount of cash they don't need, and that is the thing we really have to focus on and get the agencies to focus on. The expenditures of the recipient bear on the cash reports. To look into this is a very tedious process, requiring a great deal of staff attention. We are paying much more attention to it now. The Labor Task Force I referred to is having considerable success. I think other agencies are going to make similar strides.

Senator CHILES. I want to thank you for your testimony. Dr. White, I am delighted to hear that the Fraud and Abuse Task Force or Group is meeting on a regular basis and does have a regular agenda. I am also glad to hear about the financial priorities program, and certainly the list of items that the program in this area is working on is tremendously important.

Mr. WHITE. Thank you, Mr. Chairman.

Senator CHILES. I am disappointed because this wasn't done yesterday. I will continue to be that way. I think it is tremendously important to follow this up.

Mr. WHITE. I agree, Mr. Chairman. The one lesson that I have become absolutely convinced of in this whole area is the results of success will come from continued emphasis, frankly by you as well as by us. If we have that, I think we will have the success.

Senator CHILES. Thank you very much.

Mr. WHITE. Thank you very much.

[The prepared statement of Mr. White follows:]



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

FOR RELEASE ON DELIVERY
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STATEMENT OF DR. JOHN P. WHITE
DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS, SUBCOMMITTEE
ON SPENDING PRACTICES AND OPEN GOVERNMENT

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to discuss with you the question of grant auditing and the Administration's efforts to deal with the problems of fraud, waste, and error in federally assisted programs.

As you know, in fiscal 1980 Federal aid will amount to almost \$90 billion, of which about \$84 billion will go to State and local governments. The remainder will go to universities, hospitals, and nonprofit organizations. Grant programs are carried out by practically every department and major agency of the Federal Government, and affect virtually every segment of our society. With so much of the Federal tax dollar being spent by non-Federal organizations, the need for accountability and audit becomes critically important.

This Administration is deeply committed to making Government more accountable. We have moved on every front to eliminate fraud, abuse, and waste, and to bring strong management control to Government. We view effective audit as an indispensable tool in building a more efficient Government.

President Carter, in his first year in office, called upon the heads of departments and agencies to improve their audit systems, particularly as they relate to grant programs. He urged them to upgrade audit planning, and to "use their audit plans as a basis for making greater efforts to improve interagency cooperation on audits, to increase Federal coordination with State and local auditors, and to increase reliance on audits made by others."

Single Audit Concept

Last October, after two years of study and consultation, OMB revised the audit rules in Circular A-102, "Uniform requirements for grants to State and local governments."

The new rules built upon the President's statement of September 1977 that, "All three levels of government have audit responsibilities, but it does not make sense for them all to audit the same transactions." The Circular made it clear that recipients of Federal aid are responsible for a basic audit of programs they carry out, and that Federal audits should build upon audit work already done at the recipient level.

This approach has been called the "Single Audit Concept," because it gets away from grant-by-grant audits, and moves toward audits of an organization as a whole. The single audit concept had been urged by the General Accounting Office, the Joint Financial Management Improvement Program, and State and local officials.

The revised Circular said OMB would do three things:

- Work with GAO on revisions to a standard audit guide that would replace almost 100 individual program guides.
- Publish a "cognizance" list, naming one Federal agency to act for all in assuring that proper audits are made of State and local agencies.
- Publish a "compliance supplement" that would summarize the major audit compliance features of big Federal aid programs.

Here is what had been done.

- The GAO standard audit guide has been revised and reissued. It was co-signed by the Comptroller General and the Director of OMB. This was the first joint issuance by these agencies that we are aware of.
- A cognizance list has been published for comment, containing over 800 State agencies that are the major recipients of Federal aid. After minor revision, the list will be finalized in a few weeks.
- We are about to issue the compliance supplement for 60 programs that make up over 90% of Federal aid. This has been developed cooperatively with the agencies, and with advice from State and local auditors. We hope this, too, will be co-signed by the Director and the Comptroller General.

- We have underway a number of monitored audits that use the single audit approach. OMB, working with cognizant agencies, will keep a close eye on these audits to see how well they meet our needs.
- Finally, we intend to extend this concept shortly to other types of grantees such as Community Action Agencies, Indian Tribes, and Councils of Government.

We believe these changes represent a fundamental reform of the grant auditing process. We recognize that reform takes time, and that many details will have to be worked out as we go along.

In addition to grant audit reform, we have taken a number of related steps to improve accountability in Government programs. These initiatives involve the Inspectors General, the Executive Group to Combat Fraud and Waste, and the Financial Priorities Program.

Inspectors General

Enactment of the Inspector General Act provided a major opportunity for the President to address the issue of fraud and waste directly. The President was determined to make the Inspector General legislation a success. He took a number of steps designed to emphasize his continued support of government-wide efforts to combat fraud and waste and improve management.

-- In November 1978 in his first communication to the affected department and agency heads on implementation of the Inspector General Act, the President said:

"One of the highest priorities of my Administration is the detection and prevention of fraud, waste, and inefficiency in the operation of Federal programs." He went on to emphasize that he was taking "...very seriously our obligation to conduct the public's business with the utmost integrity."

-- In December 1978 he communicated to the heads of all departments and agencies, saying "Today, I am directing that significant features of the Inspector General program be extended throughout the Federal Government. Eliminating waste, fraud, and error should be as important to you as your program objectives." The agency heads were asked to designate a single official, accountable directly to them, to oversee their agencies' efforts to eliminate waste, fraud, and error.

-- In May 1979 he created the Executive Group to Combat Fraud and Waste in Government.

Executive Group

The Executive Group to Combat Fraud and Waste is an interagency mechanism designed to marshal government-wide

support for the Inspector General program and other efforts to combat fraud and waste. The Deputy Attorney General serves as chairman of the Group, and I serve as vice-chairman. The Group's membership includes all of the statutory Inspectors General, the Deputy Director of the Office of Personnel Management, and the Special Counsel of the Merit Systems Protection Board. The Federal Bureau of Investigation, Internal Revenue Service, and Postal Inspection Service are also represented.

Financial Priorities Program

Last May we announced the launching of a Financial Priorities Program aimed at resolving the major financial issues facing Government.

When this program began, agency financial systems had many weaknesses. There were reports of major breakdowns in fund control, with millions of dollars being overobligated. Audit reports citing billions of dollars in questioned costs were going unresolved, sometimes for years. Hundreds of millions in unspent grant funds were being retained by recipients. Cash management practices and debt collection practices were very poor.

The program is designed to direct top management attention to needed improvements in agency financial systems. The priorities were worked out by OMB in consultation with the Congress, the Comptroller General, and the agencies. The priorities that were agreed to by this group were:

- Accounting systems: The goal of this effort is to obtain General Accounting Office approval of all accounting systems.
- Internal control: The program will upgrade control systems to reduce the risk of fraud, abuse, waste and inefficiency. We expect to receive a report from the task force working on this project within the next two months, and to issue guidance to agencies shortly after that.
- Cash management: The program will build upon the work of the President's Cash Management Project.
- Audit follow-up: The purpose of work in this area will go to resolve audit findings promptly and properly.
- Outlay estimating: The program will seek to improve accuracy and timeliness in estimating outlays.
- Debt collection: The program will encourage proper accounting, and prompt aggressive debt collection.
- Overtime: Accurate accounting, and tighter control of overtime are the objectives in this area.
- Grant financing: The program will try to increase the use of letters-of-credit and electronic funds transfer, and recover unspent funds.

-- Grant accountability: The program will seek the full implementation of cost principles and standard administrative requirements.

During the last few months, the Comptroller General, Director McIntyre and I have met with Cabinet members and heads of major agencies to discuss this program. We have obtained commitments from the agencies to move aggressively to correct deficiencies. In addition, the program has been fully integrated with our regular budget review process. We have used the entire resources of OMB to press the agencies for progress.

Conclusion

We believe all these efforts, taken together, represent an unprecedented commitment by this Administration to accountability. But we know much remains to be done.

We expect to continue to work closely with the General Accounting Office on this, as well as with the Executive Group to Combat Fraud and Waste, the Intergovernmental Audit Forums, and the Joint Financial Management Improvement Program. We know that we can also count on the continued cooperation and support of this Committee and other Members of the Congress.

We recognize that for many years Senator Chiles and this Subcommittee have been in the forefront of efforts to improve accountability in Government. The Administration is strongly committed to the same objective. Let us move ahead together then, to see that needed improvements are put in place.

Mr. Chairman, that completes my statement. We will be glad to answer any questions you may have.

Senator CHILES. Our next witness has come all the way from California, Mr. Arnold Schuler, the deputy State controller of the State of California. Mr. Schuler is accompanied by John Chen, controller, Division of Audits.

Gentlemen, we welcome you to our meeting today. We are delighted to have your appearance. We welcome your statement today.

TESTIMONY OF ARNOLD SCHULER, DEPUTY STATE CONTROLLER OF THE STATE OF CALIFORNIA, ACCOMPANIED BY JOHN CHEN, CONTROLLER'S DIVISION OF AUDITS

Mr. SCHULER. Thank you. I am Arnold Schuler. I am deputy State controller of the State of California. I am here representing Kenneth J. Cory, who is the controller and was unable to be here today.

Senator CHILES. Your statement in full will be placed in the record at the conclusion of your testimony. If you can summarize it for us a little bit, it will help us on our time.

Mr. SCHULER. Fine. I will try to summarize it as much as possible.

Senator CHILES. If you can. It will just give us more time to ask you questions. We do have a number of other witnesses this morning.

Mr. SCHULER. As you all know, the magnitude of federally assisted programs has expanded dramatically in recent years. Federal grant expenditures have increased from \$11 billion in 1965 to about \$85 billion in 1979. Currently, there are more than 1,000 Federal programs. They are being administered by 55 Federal agencies and are distributed to about 90,000 State and local governments.

As the dollar value of grants becomes larger and the administering agencies grow in number and diversity, Federal grant programs become more exposed to fraud, abuse, and mismanagement. To prevent this, program officials must rely on audits as the basic control to see that funds are spent as intended and to identify unauthorized expenditures and loss of funds from fraud and abuse.

Unfortunately, the current audit approach is disorganized and costs time and money in terms of disruption of operations. More importantly, major audit gaps exist which result in billions of dollars of reported expenditures being unaudited.

A report by GAO indicated there was about \$192 billion of approximately \$240 billion during 1974 through 1977 that went unaudited. About 80 percent weren't audited at all.

In California, as the elective fiscal officer of the State, the controller is required by the State constitution to provide sound fiscal control over receipts and disbursements of public funds within the State. Auditing is a very essential function the controller must perform in order to fulfill his constitutional responsibility.

Just roughly, we have about 130 professional staff who do that job. We audit about 27 Federal and State programs. Eleven of those programs are funded by the Federal Government.

Through the audit of these programs, we have recovered millions of dollars in overpayments because of improper use of funds and noncompliance with program requirements. For the 9 months ended March 31, 1980, at a cost of \$2.5 million, our audits have

identified over \$32 million in overpayments of State and Federal funds. That is about a 12 to 1 recovery.

Senator CHILES. That is a pretty good return.

Mr. SCHULER. Well, we feel it is close to our return on most of our audits.

While the actual recovery rate varies from program to program, based on our past experience we estimate that about 74 percent of the overpayments will be recovered. The recoveries are made either through administrative procedures of offsetting overpayments against future claims or by direct recovery from the program agency.

Despite the above results, we do not feel that our audits are being as efficiently and effectively conducted as they could be. We do not believe that we should continue to audit the same entity two, three or four times a year, performing the same procedures for different programs. We do not believe it is productive to repeatedly audit certain programs when other programs, which are clearly more substantial in terms of dollar magnitude and risk exposure, remain unaudited.

Moreover, we feel it is essential that we alter our Federal policy so that we can audit all programs and funds received by an entity, especially when we suspect fraud, abuse, waste, mismanagement or other significant problems in that program. I will elaborate on some of this.

As we mentioned before, we are currently responsible for the audit of 27 Federal and State programs. Frequently, one entity receives funds from two or more of these programs which we are auditing. Currently, like everyone else, our audits are conducted on a program-by-program, grant-by-grant basis. Under this approach, we would perform two, three, four or perhaps five audits per year of the same entity, performing essentially the same procedures each time for a different program.

Senator CHILES. You might not ever really catch them if they are actually adroit enough in switching the funds.

Mr. SCHULER. Right. When you go into an audit, you are focusing on one program, and the auditor himself is going to handicap that. His scope is limited. He is interested in getting in and getting out in terms of that particular review. So things do go unanswered.

Depending on the number of grants the entity receives, it could also be subject to audits by other auditors from various Federal, State, and local agencies as well as independent public accountants.

Our staff is currently conducting a survey of a California county to determine the number of programs it administers and the extent of audit effort in those programs. So far we have identified 45 Federal- and State-funded programs being administered by the county; 21 of these programs were either audited or are being audited by 2 Federal audit agencies, at least 4 State audit agencies, and 4 independent public accounting firms. The remaining 24 programs have not been audited. So over 50 percent of the programs aren't audited. Yet some of the programs are getting fairly extensive coverage.

In view of the above situation, we believe it only sensible that we revise our approach by performing audits on an entitywide basis

and thereby eliminate or minimize the duplication of efforts among the various audit staffs.

Senator CHILES. The county that you have looked at, with all of those audits that are being done; therefore, a tremendous amount of money would have to be expended to do those kinds of audits, we still won't know whether that county is really handling all of the money soundly because half of the programs aren't audited.

Mr. SCHULER. That is right.

Senator CHILES. So we are expending a tremendous amount of money, which is supposed to be a check, and the only real reason or justification for that audit is a check. Therefore, we end up not having a check at the end of the process.

Mr. SCHULER. Right. Whether or not the single audit concept in its entirety is the answer or whether some partial limitation is necessary remains to be seen. But certainly when an audit group goes in, if their charter was broader, they would have a chance to at least get into some of these programs that weren't looked at at all.

We made a survey of the dollar value of grants that we had audited on three federally funded programs. We found that of 419 audits completed for three Federal programs—those were the housing and urban development planning program, the traffic safety program, and the women, infants, and children program—only 52 of these grants had grant expenditures in excess of \$100,000—about 12 percent. Of the 52 grants, only 8 had grant expenditures in excess of \$200,000—about 2 percent of those audits.

In contrast, for the clean water program, which is EPA funded, we normally waive audits for grants of less than \$500,000. So in these programs, we are concentrating a lot of manpower on low dollar programs. Then we get to EPA where we find numerous problems, yet we are waiving this type of audit. So again, in terms of audit selection, we are missing some of the boat.

We believe that a professional auditor should be able to establish audit priority among the various programs and allocate resources accordingly. However, we are unable to do so because funding arrangements are made on a program-by-program basis. Our audit positions are funded by a particular program to audit only grants under that program. Even when the needs for audit in a given situation may be greater in other programs, without additional funds in that program we may not be able to provide audits dictated by the situation.

Our final area of concern deals with the effectiveness of the current audit approach in detecting fraud, abuse, and mismanagement.

Under the current approach, the scope of audit is usually limited to a particular program or grant. Often, because of the intricacies in relationships among programs, some irregularities may go undetected or unproven under this limited scope approach. There are some examples that did occur in California, so I will discuss them.

In an audit of a multifunded community-based organization, a CBO, the auditor performing a CETA grant audit encountered the following situation.

The community-based organization established a private-for-profit subsidiary under a different name. Various automobiles,

vans, and equipment were purchased under the name of the subsidiary and then leased to the nonprofit entity which was funded by grants from the Community Services Administration, CETA, and other funding sources.

In the particular grant which the auditor was auditing, the nonprofit entity leased five new vans from the profitmaking entity. The total leasing was \$30,000 for the grant year.

Upon learning of the grantee's profitmaking activities, the auditor requested and received an income statement pertaining to the \$30,000 lease income. The income statement showed that the profitmaking entity had realized a \$23,000 profit for the lease of the vans—a fairly substantial profit.

The auditor then tried, without success, to determine the origin of the money for the purchase of the new vans. However, the scope of his audit was limited to the expenditures of the program he was auditing. The new vans were not purchased initially with funds from that program.

He suspects that the community-based organization made the downpayment from cash advances from the various programs and then made the monthly payments with lease charges to the program. However, there was no way he could prove this by auditing funds from one program only.

The auditor also tried to find out what the grantee did with the profit from the lease. Again, he could not determine this by auditing only the records pertaining to the grant he was auditing.

In summary, we believe that unless all the accounting and program records of the above entity are audited at once, along with the records of its subsidiaries, certain irregularities cannot be detected under the present piecemeal approach.

This particular situation was reported to the Federal Government and they are looking into it. We understand at this time they have identified 75 checking accounts and 45 savings accounts belonging to this entity. We are not quite sure why they put together all of those kinds of devices, but maybe further companies have been formed. They also found an insurance company formed by this entity.

We have another example of community-based organizations. The CBO had acquired some land from the Department of Housing and Urban Development at very minimal costs. It then acquired from the city some condemned houses, free of charge. To finance the relocation of the houses, the community-based organization applied for and was awarded a CETA contract from two prime sponsors. Under the CETA contract, the CBO was to provide training in construction trade to CETA participants. The CETA participants were to actually move the houses.

Once the above relocation was completed, the CBO rented these houses at fair market value although discounts were provided to low-income tenants. In the instances where discounts were allowed, the Department of Housing and Urban Development made up the difference between fair market value of rents and actual rent payments.

All of the above transactions were conducted in accordance with the various program requirements. One question, however, is what did the CBO do with the rent income from the houses. Again,

under the current program-by-program, grant-by-grant approach, the auditor would not be able to determine this.

Again, this was turned over to the Federal Government and apparently their audit staffs are considering looking at it.

Our final example pertains to an audit of another community-based organization. The auditor discovered that the director of the agency used CETA funds to pay his personal income taxes.

Upon learning that the auditor had discovered this, the director issued another check to reimburse the CETA checking account. The second check was issued from a checking account funded by the Community Service Administration program. The director would not provide the auditor with the records pertaining to the CSA account. Shortly after the audit, the organization was dissolved, and that was turned over to the FBI.

In addition to the above examples, there is always the possibility that a multifunded entity could bill two, three, or more programs for the same service performed. Under the program-by-program audit approach, such irregularities are very difficult to detect through normal audit procedures.

GAO has put out a report that talks about some of the joint financial management improvement programs and the problems with the single audit which include:

Getting Federal auditors to rely on audits by others. That is a common problem in all other organizations, whether Federal or State.

Getting non-Federal auditors to perform audits to satisfy Federal needs. That probably is somewhat a real need.

Program requirements are too numerous and often conflict with one another. The single audit as the learning curve involved in a program like that is extensive and it will be tough to do these single audits in all programs.

Lack of funding information on grantees, particularly at the subgrant level, which inhibits effective audit planning. The big problem is how much money are these grantees getting? From whom are they getting it? How do you plan the audit if you don't know what these people are actually receiving in Federal and State funds?

Finally, procedures for audit costs reimbursement aren't clear. That is a big problem. How do you do a single audit if you don't have a source of funding for it? In order to identify the extent of the above problems as well as to obtain workable solutions there needs to be some audits conducted under the single audit approach. To our knowledge, however, only a handful have been conducted, some of which have not been successful. This has led many people to conclude that full implementation of the single audit concept is impossible.

We believe the single audit approach can work and will work provided there is commitment and it is given ample opportunity to succeed. To assist in the implementation of the approach, the State controller of California has directed his staff, in cooperation with Federal audit agencies and local auditors, to perform a pilot audit in accordance with guidelines prescribed in attachment P. Based upon the results of this pilot project, our office would then expand

our audit efforts in this area by performing similar audits of other Governmental units and community-based organizations.

A medium-sized California county, Alameda County, was selected for the pilot audit. We have contacted the Office of Management and Budget seeking their guidance on the project. We have also contacted the Inspector General's office of the Department of Health and Human Services requesting their participation on this project as the cognizant agency.

Both agencies have been very helpful in providing technical guidance and assistance. However, there has been no formal agreement to clearly identify the responsibilities of the respective agencies. Also, the issue of how the pilot project will be funded is still unresolved.

In addition to the above Federal agencies, we presented the single audit concept and the pilot project to members of the California Association of Auditor-Controllers, which is a very influential group in California. They are very positive about this particular project.

Currently we are making a survey in Alameda County. We are trying to determine first, what are the potential problems in making this review. Second, we are making a plan for the pilot audit.

We expect to start the actual field work on October 1, 1980. However, before we can start the field work, we have to get the audit reimbursement subject resolved.

We think that the audit is going to cost about \$500,000. The current OMB position on reimbursement is that audit costs should be paid by the entity being audited and then recovered through its cost allocation plan. However, for various reasons, the county is not in a position to do so. Therefore, unless some direct funding for the project through the State controller is made available, there will be no funds available for this pilot.

In our opinion, the single audit approach is the most logical but untested approach to audits of federally assisted programs. Despite the problems, we believe the single audit approach can and will work. It makes too much sense not to work. We understand that many Federal agencies such as OMB and GAO are committed to the cause of implementing this process. Speaking from the State auditors' viewpoint, and particularly from the State controller of California's viewpoint, we welcome this commitment and we will do everything we can to help in its implementation. We are certain that with cooperation among Federal, State, and local agencies, the single audit concept will be implemented successfully, which will result in better accountability in governments and more effective and efficient use of limited audit resources.

That is the end of my statement.

Senator CHILES. Thank you for your statement.

The ability of the State to charge overpayments to grantees off of future grants, thereby decreasing the grantee's request, seems like a good idea. You all have found that practice to be effective?

Mr. SCHULER. Well, in terms of counties, which have large sums of money available to them on a continuing basis, offsetting does work and we have been successful with it.

However, if you take a small grant program offsetting is probably a little more difficult because of the fact they don't have a continuing source of funds. They have overspent, and there is a practical problem of where they can get the money. But if they do have future moneys coming, it is a possibility. The bigger they are, the better the chance of offsetting.

Senator CHILES. Your office audits other State agencies, local governments, as well as community-based organizations. Which of these organizations do you anticipate would have the greatest amount of overpayments and would be the source of your largest recoveries?

Mr. SCHULER. In terms of dollars, the county would have the largest overpayments. But in terms of percentage of overpayments, we would find more difficulties with the smaller, less structured organizations that don't have as good management or fiscal control, as the counties. These small organizations actually need the most help.

Senator CHILES. What are your thoughts as to how you should try to set up the payment of expense for single audits?

Mr. SCHULER. In terms of the audits that we would make, we really feel we need some direct funding in order to get these things under control.

Senator CHILES. Direct funding from the Federal Government?

Mr. SCHULER. Yes, sir.

Senator CHILES. How would you budget for that consideration?

Mr. SCHULER. We would probably have to contract with the Federal Government in some manner in order to receive that money. Then we would receive it through our normal budget process in the State.

Senator CHILES. Do you now know or are you able to pull together a figure from your computers or from your records that would show in effect how much you spent for audit functions, the old way of doing it, how much you were reimbursed, and how much the Federal Government was paying? Would that give you a ball park figure so that off of that you could work out some kind of contract based on some percentage of that figure?

Mr. SCHULER. I don't understand the question.

Senator CHILES. We are now talking about all of these programs that you are administering from the Federal Government.

Mr. SCHULER. That is correct.

Senator CHILES. Many of those programs provide for an item of expense for the auditing that is required to be done in those programs.

Mr. SCHULER. Right.

Senator CHILES. What I am asking is can you pull out the figure for 1978, 1977, that the Federal Government reimbursed you for/or advanced to you for an expense of auditing those programs and use that as a basis of saying, take some percentage of that and give us that money up front?

Mr. SCHULER. If I understand your question, we actually expect to recover this year in dollars about \$16 million for the Federal Government. Our entire audit program cost is about \$2.5 million. So we probably would feel that our recovery ratio in this program would be about the same, about 12 to 1.

Senator CHILES. That is the recovery ratio of what you got back by virtue of counties or other agencies spending money that they shouldn't have.

Mr. SCHULER. Right.

Senator CHILES. But now that \$2.5 million that you spent auditing, how much did the Federal Government give you for that \$2.5 million? Was all of that given?

Mr. SCHULER. No; it is about in the same ratio. The Federal Government participates in roughly 50 percent of our costs. That is a ball park figure.

They gave us \$2 million of the \$2.5 million last year. The recovery that they received back was about in the same ratio also.

Senator CHILES. They received back how much of the recovery and how much did you keep?

Mr. SCHULER. We expect to recover about \$24 million in hard dollars. The Federal Government will recoup about \$16.5 million.

Senator CHILES. Will they leave the rest with you?

Mr. SCHULER. Yes, sir, because the rest of that is State funds. And we will be billing them about \$2 million for the audit activities.

Senator CHILES. As I understand it, one of the big problems you now have in your county is that someone has to get this process rolling. The county says, "We don't have the money up front to get that started." So there needs to be some basis on which the Federal Government would make some kind of advance to you that they could in turn make to the county.

Mr. SCHULER. That is correct. We need some seed money to get the staff started on this, to develop the learning curve in order to get this job and future jobs underway.

Senator CHILES. If the Federal Government was to advance to you, say, \$1 million, that being approximately half of what they paid you the last year you had, would that be the kind of advance money you would need?

Mr. SCHULER. Yes, sir, we are looking at the Alameda County audit costing around \$500,000.

Senator CHILES. That particular one?

Mr. SCHULER. Right. But we would like to expand that concept. We think the number is around \$1 to \$1.5 million for a complete pilot. We would start this pilot out very slowly and take a hard look at it as we progress. We would also expect to report back to the Congress and the executive agencies on our results, because again, like anything new, it isn't going to be a perfect process. We want everybody to know what the high and low sides are.

Senator CHILES. I see the point that you raised, which is probably valid, not to set in stone you have to have a single audit of everything, which everything might not be productive or might not make sense costwise. But there needs to be some kind of way of adopting a plan whereby you would look at the dollars that are being expended and decide what areas you would single audit on the basis of that kind of plan.

Thank you very much for your testimony. I think it is very helpful to us. I appreciate your appearance here.

Mr. SCHULER. Thank you, Mr. Chairman. It was an honor to testify before your subcommittee.

[The prepared statement of Mr. Schuler follows:]

PREPARED STATEMENT OF F. ARNOLD SCHULER, DEPUTY STATE CONTROLLER,
STATE OF CALIFORNIA

Mr. Chairman and Members of the Subcommittee:

My name is Arnold Schuler, I am the Deputy State Controller of the State of California. With me today is John Chen from the Audits Division of our office. On behalf of the State Controller, Mr. Kenneth Cory, we would like to present to you our concerns regarding the problems in auditing federally assisted programs.

As you all know, the magnitude of federally assisted programs has expanded drastically in recent years. Federal grant expenditures have increased from 11 billion dollars in 1965 to about 85 billion dollars in 1979. Currently, there are more than 1,000 federal programs. They are being administered by 55 federal agencies and are distributed to about 90,000 state and local governments.

As the dollar value of grants become larger and the administering agencies grow in number and diversity, federal grant programs become more exposed to fraud, abuse and mismanagement. To prevent this, program officials rely on audit as the basic control to see that funds are spent as intended and to identify unauthorized expenditures and loss of funds from fraud and abuse.

Important as auditing is, the current disorganized approach to grant auditing costs time and money in terms of duplication of audit efforts and disruption of operations. More importantly, under the current approach, major audit gaps exist which result in billions of dollars of reported expenditures being unaudited.

In a report to Congress in 1979 entitled Grant Auditing: Reform Needed, the Comptroller General of the United States indicated the problem is so widespread that possibly the government did not provide audits for nearly 192 billion dollars of the approximately 240 billion dollars in grants awarded during 1974 through 1977.

The prepared statement of Mr. Schuler follows:

As the elective fiscal officer of the State, the State Controller is required by the State Constitution to provide sound fiscal control over receipts and disbursements of public funds within the State. Auditing, of course, is a very essential function that the Controller has to perform in order to fulfill his constitutional responsibility. Such function is being performed by the staff in the Audits Division.

Currently, the Audits Division has over 130 professional staff, performing audits of 27 federal and state programs. Some of these staff positions are funded through direct appropriation from the State General Fund. The others are funded through contractual arrangements with other federal and state agencies requesting the audits. Of the 27 programs being audited, 11 are funded by the federal government. Examples of these include the Comprehensive Employment and Training Act (CETA) program administered by the Department of Labor, the Welfare Program and the Medi-Cal Program administered by the Department of Health and Human Services, and the Clean Water Program by the Environmental Protection Agency. Entities audited include other state agencies, local governments and community based organizations.

Through the audits of these programs, we have recovered millions of dollars in overpayments because of improper use of funds and noncompliance with program requirements. For the nine months ended March 31, 1980, at a cost of 2.5 million dollars, our audits have identified over 32 million dollars in overpayments of state and federal funds for recovery. While the actual recovery rate varies from program to program, based on our past experience we estimate that about 74 percent (approximately 24 million dollars) of the overpayments will be recovered. Recoveries are made through either administrative procedures of offsetting overpayments against future claims filed with the state or direct recovery by program officials.

Despite the above results, we do not feel that our audits are being conducted as efficiently and effectively as they should have or could have. We do not believe that we should continue to audit the same entity two, three, four, or five times a year, performing the same procedures for different programs. We do not believe it is productive to repeatedly audit certain programs when other programs, which are clearly more substantial in terms of dollar magnitude and risk exposure, remain unaudited. Moreover, we feel it is essential that we alter our federal policies so that we can audit all programs and funds received by an entity, especially when we suspect fraud, abuse, waste, mismanagement, or other significant problems in that program. Let me briefly elaborate on these points.

As we mentioned before, we are currently responsible for the audit of 27 federal and state programs. Frequently, one entity receives funds from two or more of these programs which we are auditing. Currently, like everyone else, our audits are conducted on a program-by-program, grant-by-grant basis. Under this approach, we would perform two, three, four, or perhaps five audits per year of the same entity, performing essentially the same procedures each time for a different program. Depending on the number of grants the entity receives, it could also be subject to audits by other auditors from various federal, state and local agencies as well as independent public accountants.

Our staff is currently conducting a survey of a California county to determine the number of programs it administers and the extent of audit effort in those programs. So far, we have identified 45 federal and state funded programs being administered by the county. Twenty-one of these programs were either audited or are being audited by two federal audit agencies, at least four state audit agencies, and four independent public accounting firms. The remaining 24 programs have not been audited.

In view of the above situation, we believe it only sensible that we revise our approach by performing audits on an entity-wide basis and thereby eliminate or minimize the duplication of efforts among the various audit staffs.

Our next area of concern pertains to the selection of programs and grants for audit. Currently, because audit coverages are determined on a program-by-program basis, certain grant programs are audited much more extensively than others. We believe some of these programs should be audited less extensively while audit effort of other programs needs to be emphasized. Let me give you an example.

We made a survey of the dollar value of the grants that we had audited on three federally funded programs. We found that of 419 audits completed for three federal programs (Housing and Urban Development Planning Program, Traffic Safety Program, and Women, Infants and Children Program), only 52 of these grants had grant expenditures in excess of 100,000 dollars. Of the 52 grants, only eight had grant expenditures in excess of 200,000 dollars. In contrast, for the Clean Water Program which is also a federally funded programs, audits are normally waived for grants under 500,000 dollars because of limited audit resources.

We believe that as professional auditors we should be able to establish audit priority among the various programs and allocate our resources accordingly. However, we are unable to do so because funding arrangements are made on a program-by-program basis. Our audit positions are funded by a particular program to audit only grants under that program. Even when the needs for audit in a given situation may be greater in another program, without additional funds in that program we may not be able to provide audits dictated by the situation.

Our final area of concern deals with the effectiveness of the current audit approach in detecting fraud, abuse, and mismanagement.

Under the current approach, the scope of audit is usually limited to a particular program or grant. Often, because of the intricacies in relationships among programs, some irregularities may go undetected or unproven under this limited scope approach. Let me give you some examples on how this happens.

In an audit of a multi-funded community based organization (CBO) the auditor performing a CETA grant audit encountered the following situation:

The CBO has established a private-for-profit subsidiary under a different name. Various automobiles, vans and equipment were purchased under the name of subsidiary and then leased to the nonprofit entity which is funded by grants from Community Service Administration, CETA, and other funding sources.

In the particular grant the auditor was auditing, the nonprofit entity leased five new vans from the profit-making entity. Total lease payment for the five vans was 30,000 dollars for the grant year.

Upon learning of the grantee's profit-making activities, the auditor requested and received an income statement pertaining to the 30,000 dollars lease income. The income statement showed that the profit-making entity had realized a 23,000 dollar profit for the lease of the vans.

The auditor then tried, without success, to determine where the money for the purchase of the new vans came from. The scope of his audit was limited to the expenditures of the program he was auditing. The new vans were not purchased initially with funds from that program.

He suspects the CBO made the down payment with cash advances from the various programs and then made the monthly payments with lease charges to the program. However, there was no way he could prove this by auditing funds from one program only.

The auditor also tried to find out what the grantee did with the profit from the lease. Again, he could not determine this by auditing only the records pertaining to the grant he was auditing.

In summary, we believe that unless all the accounting and program records of the above entity are audited at once, along with the records of its subsidiaries, certain irregularities cannot be detected under the present piecemeal approach.

Our next example also concerns a community based organization in Los Angeles.

The CBO had acquired some land from the Department of Housing and Urban Development at very minimal costs. It then acquired from the City some condemned houses, free of charge, because they were too close to the airport runway.

To finance the relocation of the houses, the CBO applied for and was awarded CETA contracts from two prime sponsors. Under the CETA contract, the CBO was to provide training in construction trade to CETA participants. The CETA participants were to actually move the houses.

The CBO retained titles to all the houses. Once the above relocation was completed, the CBO rented these houses out at fair market value although discounts were provided to low income tenants. In the instances where discounts were allowed, the Department of Housing and Urban Development made up the difference between fair market value of rents and actual rent payments.

All the above transactions are conducted in accordance with the various program requirements. Our question, however, is what the CEO did with the rent income from the houses. Again, under the current program-by-program, grant-by-grant approach, the auditor would not be able to determine this.

Our final example pertains to an audit of another community based organization. The auditor discovered that the Director of the agency used CETA funds to pay for his personal income tax return. Upon learning that the auditor had discovered this, the Director issued another check to reimburse the CETA checking account. The second check was issued from a checking account funded by the Community Service Administration program. The Director would not provide the auditor with the records pertaining to the CEA account. Shortly after the audit, the organization was dissolved.

In addition to the above examples, there is always the possibility that a multi-funded entity could bill two, three or even more programs for the same service performed. Under the program-by-program audit approach, such irregularities are very difficult to detect through normal audit procedures.

In October 1979, the Office of Management and Budget issued Attachment P to OMB Circular A-102. The Attachment requires that audits of federally assisted programs be conducted on an organization-wide basis. If implemented, this new approach would eliminate the previously mentioned problems.

Despite the desirability of this organization-wide approach to audits, there are many practical problems remaining to be resolved. In a report entitled Report on Audit of Federally Assisted Programs: A New Emphasis, the Joint Financial Management Improvement Program (JFMIP) identified some of the problems as:

- Getting federal auditors to rely on audits by others.
- Getting non-federal auditors to perform audits to satisfy federal needs.
- Program requirements are too numerous and often are in conflict with one another.
- Lack of funding information on grantee, particularly at the subgrant level, to enable effective audit planning.
- Procedures for audit costs reimbursement are inadequate.

In order to identify the extent of the above problems, as well as to attain workable solutions, there needs to be some audits conducted under the single audit approach. To our knowledge, however, only a handful have been conducted, none of which have not been successful. This has led many people to conclude that full implementation of the single audit concept is impossible.

We believe the single audit approach can work and will work provided there is commitment and given ample opportunity to succeed. To assist in the implementation of the approach, the State Controller has directed his staff, in cooperation with federal audit agencies and local auditors, to perform a pilot audit in accordance with guidelines prescribed in Attachment F. When this pilot project is completed, we would then expand our audit efforts in this area by performing similar audits of other governmental units and community based organizations.

A medium sized California county, Alameda County, was selected for the pilot audit. We have contacted the Office of Management and Budget seeking their guidance on the project. We have also contacted the Inspector General's Office of the Department of Health and Human Services requesting their participation on this project as the cognizant agency. Both agencies have been very helpful in providing technical guidance and assistance. However, there has been no formal agreement to clearly identify the responsibilities of the respective agencies. Also, the issue of how the pilot project will be funded is still unresolved.

In addition to the two above federal agencies, we presented the single audit concept and the pilot project to members of the California Association of Auditor-Controllers. The Association has endorsed both the concept and the pilot project and is willing to do whatever they can to help.

We have also discussed the pilot project with officials from Alameda County. They are very enthusiastic about this project and promised their cooperation.

Currently, we have two staff members in Alameda County, performing a preliminary survey of the County's accounting system. The purpose of the survey is twofold: first, to identify potential problems in advance and seek solutions. Second, to devise a plan for the pilot audit.

The actual audit field work is expected to start about October 1, 1980. Before the field work can be started, however, the problem of audit costs reimbursement has to be resolved.

Our preliminary estimate of the cost of the pilot audit is 500,000 dollars. The current OMB position on reimbursement is that audit costs should be paid by the entity being audited and then recovered through its cost allocation plan. However, for various reasons, the County is not in a position to do so. Therefore, unless some direct funding is made available, there would be no funds available for the pilot audit.

In our opinion, the single audit approach is the most logical but untested approach to audits of federally assisted programs. Despite the problems, we believe the single audit approach can and will work. It makes too much sense not to. We understand that many federal agencies such as OMB and GAO are committed to the cause of implementing this concept. Speaking from the state auditors' viewpoint, we welcome this commitment and we will do everything we can to help in this endeavor. We are certain that, with cooperation among federal, state and local agencies, the single audit concept will be implemented successfully which will result in better accountability in governments and more effective, efficient use of limited audit resources.

Senator CHILES. We will now hear from Mr. Donald Scantlebury, the Director of the Financial and General Management Studies of the General Accounting Office.

We will put your statement in full in the record following your testimony.

You may proceed any way you wish.

TESTIMONY OF DONALD L. SCANTLEBURY, DIRECTOR, FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ROBERT RASPEN, SUPERVISORY AUDITOR, FGMSD; JOHN DOWELL, ASSISTANT REGIONAL MANAGER, CLEVELAND SUBOFFICE; AND JOSEPH STANZIALE, SUPERVISORY AUDITOR, CLEVELAND SUBOFFICE

Mr. SCANTLEBURY. Mr. Chairman, thank you. I do have a brief version which I will read.

Before I start, I would like to introduce the staff members who have been working on this, which we are performing at your request. This is Mr. John Dowell, assistant regional manager from our Cleveland suboffice; Bob Raspen on my immediate right; and Joe Stanziale further down to the right.

Senator CHILES. We are delighted to see some of you again and to have you up here.

Mr. SCANTLEBURY. On March 22, 1979, we testified before the Senate's Subcommittee on Labor, Health, Education, and Welfare on the preliminary results of our review. Since that testimony, we have been analyzing those instances to determine whether breakdowns of internal controls permitted them to occur. We found that internal control breakdowns occurred at both the council and the Federal agencies administering the program.

Good internal controls are the most effective deterrent to fraud, embezzlement, and related illegal acts. Internal controls are the body of checks and balances which organizations set up to spread work out in such a way that one person or function checks on what another person or function does, to see that it is carried out properly.

We found that the council violated good internal controls. In fact, we found few checks and balances and that the accounting records and reports could not always be relied on because in some instances they were used to help conceal fraud and abuse.

Today I would like to discuss the breakdowns of internal controls which permitted the fraud and abuse to occur and the breakdowns of auditing procedures which permitted them to go undetected or uncorrected.

The diversion of Federal funds into three unrecorded savings accounts took place in 1973 and 1976. Neither the savings accounts nor the interest earned on them were recorded on the council's books or reported to CSA.

An effective internal control system would have prevented the establishment of unrecorded bank accounts or at least would have disclosed their existence. An effective system would have separated the physical receipt and depositing of cash, the recording of cash receipts in the accounting records, and the receipt of bank state-

ments. At the council, these functions were controlled by one individual.

The auditors reviewing the CSA funds did not discover the diversion because they did not perform an audit procedure which would have alerted them to the diversions. This procedure is to confirm with CSA the amounts and dates of funds transferred to the council. Such confirmation is required by CSA regulations.

CSA did not discover the diversion because it did not adequately analyze the auditor's report which showed that CSA owed the council \$448,000. The former finance director was convicted of embezzling \$120,000 by depositing—

Senator CHILES. Let me ask you a couple questions as you go along to try to understand that.

So you are saying that CSA regulations required that kind of control?

Mr. SCANTLEBURY. Required that the auditors question CSA as how much money has been paid to this organization and on what dates.

Senator CHILES. But the auditors didn't follow that requirement?

Mr. SCANTLEBURY. They did not.

Senator CHILES. Then because CSA didn't read that audit to see they hadn't done it—

Mr. SCANTLEBURY. They hadn't reconciled the report with their records, so they didn't pick up the differences, either.

Senator CHILES. So you really had a chain of breakdowns there.

Mr. SCANTLEBURY. Yes.

Senator CHILES. The requirement was there, so it wasn't a breakdown in the requirement.

Mr. SCANTLEBURY. Right.

Senator CHILES. That particular requirement was there.

Mr. SCANTLEBURY. It was not observed in the implementation.

Senator CHILES. The auditor didn't follow the requirement and CSA didn't check to see whether the auditor had followed the requirement.

Mr. SCANTLEBURY. That is correct.

The former finance director was convicted of embezzling \$120,000 by depositing idle HEW funds into a personal savings account. He was able to do this because he had complete control over cash disbursements.

An effective internal control system could have prevented this because it would have segregated duties so that one person would not have control over the entire transaction.

The CPA firm auditing—

Senator CHILES. Now tell me about that control. Was that kind of a control required by regulations?

I am trying to find out where was the breakdown in not having the control to start with, and where was the breakdown that kept you from following through on the control you already had.

Mr. RASPEN. CSA regulations have established internal control procedures.

Senator CHILES. Did they at the time in Cleveland? Was that a requirement?

Mr. RASPEN. Internal control procedures are standard and they are required of all Federal programs, so I am sure it is required of CSA.

Senator CHILES. Again, the control was there.

Mr. RASPEN. We have looked at CSA's vulnerability to fraud and abuse during another job and established that their control procedures are good on paper. In most cases it is just that they are not implemented.

Mr. SCANTLEBURY. Mr. Chairman, I might say that is one of the most basic internal control procedures there is.

Senator CHILES. I understand it is. I just wanted to make sure whether that basic one was there.

Mr. SCANTLEBURY. That is one of the first things you look for when you assess internal control as an auditor is to see whether they have the responsibilities segregated to provide effective control.

Senator CHILES. It is like having two people cosign a check, and putting it in different accounts.

Mr. SCANTLEBURY. Yes, sir.

Senator CHILES. All right.

Mr. SCANTLEBURY. The CPA firm auditing CSA funds recognized and reported a year before the embezzlement that internal controls over disbursements were weak. However, neither CSA nor the council took action to correct the problem until after the embezzlement was discovered.

Over the past several years the council freely loaned money between Federal programs. This is another problem.

Senator CHILES. Let me go back and ask you on this problem then. Recognizing that here we had some controls that were there, they were not followed, and in one instance the auditor didn't pick them up and in another instance did pick them up, and even where they were picked up nobody at CSA required any followup, how are we going to be able to remedy a situation like that?

You know, I would feel a lot better if we said there just wasn't a control there but now we have a control so everything is fine. But here we find that we had a control and there was a breakdown in two instances.

Mr. SCANTLEBURY. One of the purposes of having audits made is to find out about these kinds of weaknesses.

Senator CHILES. Right.

Mr. SCANTLEBURY. One of the things, if we are going to get effective control over the grantees, that the Federal agencies are going to have to do is read these reports and when there is some problem take action to see that it is corrected.

Senator CHILES. How are we going to see that they do that?

Mr. SCANTLEBURY. Well, I guess one of the ways is now that we are aware of the problem, we will make periodic examinations of the agencies to see that they are doing that.

Senator CHILES. At some stage don't we have to have somebody at CSA or any agency responsible and hold that individual responsible? Has anybody at CSA been docked a day's pay because of this?

Mr. SCANTLEBURY. I doubt that very much. [Laughter.]

Senator CHILES. Nobody was transferred? Nobody was fired? Nothing happened? The Government was just out the money.

Mr. SCANTLEBURY. By and large, our work in this area has disclosed that usually there are program managers or grant managers who are responsible for managing the individual grants. And just in general their diligence in looking at these financial matters and seeing that these things are resolved has been at a pretty low level.

You know, we reported in one report that \$4.3 billion—you have referred to that—

Senator CHILES. I have used that figure a lot.

Mr. SCANTLEBURY. There were that many unresolved audit findings. Much of that was because this was a low-priority item as far as these managers were concerned and action just wasn't taken.

Senator CHILES. What I am trying to do is figure it out so you won't be wasting your time and I won't be wasting mine and we won't just be putting on these horror stories, making people more and more distrustful of their Government and realizing it is not working.

So even when we talk about having the controls, that is fine; have the audit, that is fine; getting some kind of a single audit, that is fine. But if nobody is going to read that audit and if nobody, picks it up, who will be responsible for followup if there is no accountability and no responsibility assessed by failure to do that, I think we are wasting our time.

I think we can get OMB to implement the single audit. We can force maybe legislation, if necessary; appropriations language, if necessary. We can do all of these things. But we wouldn't have accomplished anything.

Mr. SCANTLEBURY. One suggestion I could make is, this. In most of the agencies now, the people who are at the supergrade level have to make an agreement between themselves and their superiors as to the job that they will carry out. If they don't fulfill those agreements, they can be downgraded to a lower grade and moved to a job of less responsibility. In their agreements they have what they call critical job elements which are those factors that they must do properly in order to fulfill their requirement.

Senator CHILES. Do you know whether any of those critical job elements is that you are going to read the audit report?

Mr. SCANTLEBURY. No. Well, that might well be one they should recommend be put in for those people who are managing grant programs.

Senator CHILES. I think we just have to get something like that in. I think if there isn't going to be some kind of a personal responsibility and accountability—which I think is the biggest breakdown I find in Government, and how it differs from the private sector entirely, is that there is never any sort of day of reckoning or day of accountability. You go along and get along. The promotions seem to come on the basis of not the kind of job you do but who you know or how much time you have spent there; in too many instances who you know, how well you get along, rather than the kind of job you are doing.

Mr. SCANTLEBURY. You know, to just roundout the discussion, they have in the agencies, at least they reported to us, established

new procedures for dealing with this situation. I don't know yet how effective those are.

We have an audit which we have started recently in which we are following up on their actions to try to collect the \$4.3 billion. Most of them were using this new management approach that they had devised as a result of our report.

Senator CHILES. Do you ever in your audit, GAO, when it goes in, do you ever go as far as to say the Cleveland operation was under the control of Mr. John Smith, or in 1976 Mr. John Smith was transferred, and somebody else and somebody else. Are we ever going to say these were the people who were responsible for getting the job done, or is it always just that the agency didn't do it?

Mr. SCANTLEBURY. We usually don't name names, although we have on some occasions put in the back of our reports the people who handled certain responsible jobs, that had responsibility for the particular function during a particular period of time.

It is very difficult in many cases to put your finger on just who exactly made a particular decision because in some cases they are not documented. We find in some cases that the decision will come from a higher level and that the person who actually seems to have made the decision or would seem to be the one responsible has been ordered to do something by someone else.

So we kind of shy away from that because we have had some difficulty in deciding just who is the one who made the decision.

Senator CHILES. Again, I understand that can happen. I have seen that happen many, many times. But it seems like if everybody knows ultimately their responsibility is going to be pinpointed and retribution is going to be exacted, then a person is going to say, "Now wait a minute. If you want me to do this, you put it in writing that I do this," and everybody then starts to cover themselves once they know there is going to be an accounting day.

Mr. SCANTLEBURY. We were saying there were a number of loans made between Federal programs. Neither the council nor the Federal agencies knew the extent of the loans, nor did they know if all loans had been repaid.

The auditor, Deloitte, Haskins & Sells, who is now performing the single audit of the council, is reviewing all of the loans and interfund transfers.

Since top council officials were involved in transferring the funds between programs and accounts this would be a case where no system of internal controls would have prevented the improper loans. Generally they all were aware this was being done and I guess didn't think it was particularly wrong. However, the auditors on several occasions reported the unauthorized loans to HEW and CSA, but neither agency acted to have the practice discontinued.

In addition to the internal control breakdowns and lack of follow-up on deficiencies reported in audits, one factor significantly contributed to the three instances of abuse and misuse of Federal funds which I have just discussed. This factor is an excessive amount of Federal cash in the hands of the council. The excessive cash held by the council and other grantees results in the Treasury unnecessarily paying interest on borrowed funds. As you know, in recent months the Treasury has been paying record interest rates.

Senator CHILES. Yes, I do know that.

Mr. SCANTLEBURY. So this is an important problem.

The council was able to amass large cash balances because it drew down cash before it was needed; the Federal agencies did not recoup funds in expired or terminated grant accounts; and the council may have received dual reimbursement for certain costs. Some of the excess cash was embezzled, diverted into interest-bearing savings accounts, or loaned improperly to other programs. Failure of the Federal agencies to monitor cash balances contributed to the problem.

On January 31, 1979, the council reported that it held \$1.8 million of CSA funds on hand. Based upon average disbursements for the prior 6 months, this was 10 times its average monthly disbursement needs. Similarly, on that date, the council reported to HEW that it had cash of \$312,000 or about \$120,000 more than its monthly disbursement rate for the prior 12 months.

The council was able to accumulate large cash balances because it drew down funds before it needed them. In reviewing the quarterly financial reports to CSA, we noted that during the quarter ending October 31, 1978, the council withdrew \$1.4 million and expended only \$502,000—nearly \$900,000 more than it needed.

After we began questioning these high cash balances, the council stopped the practice of withdrawing more cash than its disbursement needs. As of May 19, 1980, the council had only \$136,000 of CSA cash on hand.

Had the Federal agencies reviewed the council's quarterly financial reports, they would have identified the excessive cash balances.

Still another source of excess funds arises from both Agriculture and HEW reimbursing food costs. Although Agriculture is primarily responsible for reimbursing grantees for food-related costs, the council was also using HEW funds to purchase food. As a result, the Agriculture checking account usually had large cash balances. In this regard, we noted that 28 loans amounting to \$450,000 were made from this account and, as of early 1979, \$42,000 of loans were still outstanding. As of September 1979, the council had \$156,000 in the Agriculture bank account.

As discussed in previous testimony, we referred several cases of credit card and travel abuses to the Department of Justice. However, because of the small dollar amounts, Justice has taken no action.

Our followup to determine if corrective action had been taken to prevent future occurrences showed that such action had not been taken. This indicates to us, the fact that Justice would not prosecute some of these smaller amounts, that the Federal agencies must insist on strong internal controls and take administrative actions to recover Federal funds involved in minor cases of program abuse.

In addition, the Federal agencies must insist that individuals involved in such abuse are subject to administrative action.

HEW had not accepted Ernst & Whinney's audit reports on the council's HEW activities for the 3 years ended January 31, 1978, because of unresolved differences. The Chicago HEW audit staff has been attempting to reconcile the differences and has reviewed the Ernst & Whinney working papers. During this review the HEW auditors raised a number of questions about the audit work

and, as a result, requested Deloitte, Haskins & Sells to do additional work during its audit of the council.

The accumulation of excess cash at the council, as well as other grantees around the country, occurs because the grantees receive too much funding authority in the first place.

The audit reports show that CSA and HEW funds available for reprogramming grew from \$656,000 in January of 1975 to \$1.6 million in January 1978. Until 1979, HEW and CSA permitted grantees with limited justification to add funds left over from prior program years to funds authorized for the current year.

Beginning in 1979, both CSA and HEW changed this procedure by requiring that grantees provide detailed justification for reprogramming funds and by deducting reprogrammed funds from the amount approved for the current program year. This approach appears fruitful.

For example, in 1979, the council requested HEW approval for reprogramming \$1.7 million leftover Head Start program funds for years ended January 31, 1978 and 1979. The council was later required to provide additional justification on the planned use of the funds. We were informed by a council official that HEW will only approve \$1.1 million of the \$1.7 million requested.

We believe that these actions, coupled with increased attention to audit reports and quarterly financial statements, will reduce excess cash balances and lessen opportunities for fraud and abuse.

The Federal agencies have taken other corrective actions which we believe will substantially improve conditions in Cleveland.

In prior testimony we pointed out that conditions at the council were never fully disclosed because different public accounting firms were hired to audit individual programs rather than one firm auditing all council activities concurrently.

For many years the General Accounting Office has advocated single audits at organizations like the council. Therefore, we believe that the engagement of Deloitte, Haskins & Sells to do the single audit at the council is a major step forward. The audit, which covers the 4-year period ended January 31, 1979, started last November, is well underway and is expected to be completed in a few months.

Other actions in Cleveland include the following:

The \$76,000 in the hidden savings account has been returned to CSA.

The council returned \$34,000 from inactive checking accounts to HEW.

CSA withdrew \$500,000 in program authority from the council. The cash held by the council has been substantially reduced.

And the council's payroll procedures have been improved.

Also, as a result of our work in Cleveland and other locations: CSA has initiated a nationwide review of drawdowns under the letter-of-credit method of financing.

HEW has begun an across-the-board survey of excess cash held by grantees.

HEW added three people to its grants administration staff in the Chicago region to review quarterly financial reports and to make field visits to grantees.

And CSA regional personnel have now begun to review quarterly financial reports and audit reports and have added this requirement to job descriptions.

That concludes my statement, Mr. Chairman. I will try to answer any questions.

Senator CHILES. I thank you for your statement. I think it speaks for itself. I don't see any concrete assurances that the identical thing isn't still going on in Cleveland.

Mr. SCANTLEBURY. We have some indications from the Deloitte, Haskins & Sells audit that there are still some problems there which further action will have to be taken to correct.

Senator CHILES. So we won't really know until we get the single audit, which is now going on, because much of their activities have still not been audited.

Mr. SCANTLEBURY. Yes. They are getting into some of the funds that had not been audited before.

Senator CHILES. So all of our stories may not be in yet.

Mr. SCANTLEBURY. That is correct.

Senator CHILES. Has there been further investigative efforts beyond what your auditors discovered? In other words, did the Inspector General or the FBI expand on any of the leads that you gave them?

Mr. SCANTLEBURY. Yes. The HEW Inspector General's representative spent some time investigating payroll irregularities at the council and travel and credit card abuse at the delegate agency. Since some of the payroll irregularities related to CSA funds, the Inspector General turned it over to the Cleveland FBI for further investigation. The FBI did receive the go-ahead to investigate payroll matters. We understand that the FBI has evidence on one council employee involved in part-time dual employment.

On the travel and credit card abuses, we don't have the complete details of how far that investigation went. The Inspector General told us the investigation was conducted with the advice and direction of the U.S. attorney's office in Cleveland. The Assistant Attorney General responsible for that case was satisfied with the scope and details of the investigation but, as I mentioned in my statement, he declined to prosecute due to lack of criminal intent and prosecuting merit. That is the reason they gave. With a small one, it is very difficult to get any action taken on a small amount.

Senator CHILES. I understand in some instances that is going to happen. The U.S. attorney is going to say, "I just can't prosecute those cases when I have other major cases that come in front of me. So I can't handle that."

You pointed out that administrative action should be taken in that regard. Has administrative action been taken?

Mr. SCANTLEBURY. Joe?

Mr. STANZIALE. In this case no, it has not been taken. It is still pending. In talking to the FBI, they are still trying to collect additional information.

Senator CHILES. Again, it seems to me it is going to be the worst kind of thing that happens if you find these situations, pinpoint them, have what is the case on merit, and then absolutely nothing is done. That signal goes out very quickly I think to everybody that it doesn't make any difference if you are caught. If you do appear

to be culpable or guilty, with reasonable grounds for a case to be made, you are not going to be prosecuted and no administrative action is going to be taken.

Mr. SCANTLEBURY. This is a matter of considerable concern to us. We have been doing some general studies of the problem in this area not only with the Federal grantees but with the Federal Government itself as to what actions are taken and whether they seem to be adequate or not.

Senator CHILES. It gets back to what I was talking about. Again, who is going to look at the audit report? There is no accountability required, even where you are guilty of stealing.

Mr. SCANTLEBURY. I will have some statistics—I don't have them at the present. We are not that far along in our work. But we are studying a number of cases in which fraud and abuse has occurred. Many of them are fairly small. I think we will be able in a couple of months to perhaps provide you with some information on how effective the administrative actions taken by Federal agencies are as a whole.

Senator CHILES. I think that would be very important. I would like to follow up on that.

Mr. SCANTLEBURY. If you would like that information, we will make it available to you when it is available.

Senator CHILES. I have great concern about that. Yes.

When you testified last October you told us about your staff findings in Detroit, among some other places. Focusing on that situation, the Neighborhood Services Department had an unusual agreement with Merrill Palmer, a delegate agency. Is Merrill Palmer still a delegate agency for the city of Detroit?

Mr. SCANTLEBURY. Yes, it still is. It has had difficulty in getting enough children into the Head Start program. They have less than half of the number of children that they are supposed to have participating. And the director of the city's Neighborhood Services Department told us that since Merrill Palmer hasn't achieved the desired enrollment in the Head Start program, the city doesn't plan to renew the contract when it runs out in about 2 months from now.

Senator CHILES. After the hearings last October, I sent some of my staff to Detroit to talk with officials there. It was my understanding there would be changes made in the administration of the Head Start program. That is what we were told.

Does the program have the same director that it had when many of the abuses that you reported on took effect or have they made changes?

Mr. SCANTLEBURY. No, they have not. The same person is still the director of the Neighborhood Services Department. The person is responsible for all programs run by the department.

Another person now has the overall responsibility for the city's Head Start program, but we understand that the other people, including the person previously in charge, are still involved in running the program.

Senator CHILES. So again nothing is done, nothing has been changed, just the same parties are there.

Mr. SCANTLEBURY. Nothing very substantial has happened.

Senator CHILES. Many of the problems in embezzlement, fund diversion and other rip-offs are generated because the Community Action agencies have this excess cash on hand that they are allowed to keep. How much excess funding is out there in these agencies, drawing interest and capable of being manipulated? Do you have any idea?

Mr. SCANTLEBURY. No, we don't. We think it is very large sums of money. We have become very concerned with this area. We have an audit now underway in which we are starting with State agencies and we are looking to see how much State agencies retained of Federal funds that should be returned to the Government. We hope to do considerable work in that area.

Senator CHILES. We are talking about hundreds of millions of dollars, are we not?

Mr. SCANTLEBURY. Yes, I think that is fair in terms of how much Federal money generally is being retained by Federal grantees that should be paid back to the Government.

Senator CHILES. How are we going to get a handle on how much CSA has out?

Mr. RASPEN. CSA has a requirement that grantees provide quarterly financial statements to CSA. This statement, if verified for accuracy would provide a picture for CSA to follow.

Senator CHILES. Has anybody looked at that or run a total on those quarterly statements?

Mr. RASPEN. When we looked at Cleveland, no one was looking at the quarterly statements. In fact, some of them were very inaccurate. Even the CPA was not looking at it.

From the standpoint of Cleveland, the CSA people told us they didn't have the staff to look at them.

Senator CHILES. So one, we don't know whether that quarterly financial statement was accurate. Even if it was, in areas where it was, nobody was looking at it.

Mr. RASPEN. No.

Senator CHILES. CSA doesn't have computer capability of pushing the button and throwing the total on what the quarterly statement shows as the outstanding statements total?

Mr. RASPEN. Not to my knowledge. Again, I think CSA would be the proper person to answer that. I don't know for sure.

Mr. SCANTLEBURY. I might say one of the problems is some of the moneys out there are not recorded in the records. So our procedure has been to go out to the grantee level and take a look at some of the grantees to see how much money they actually have there that is Federal funds that should be returned. We hope to make some recommendations at the completion of our work about how the Federal Government can strengthen its control over those funds.

Senator CHILES. We would like very much to have those recommendations.

You testified the United Planning Organization here in Washington was among those agencies which kept a large cash balance. Is that still true of UPO?

Mr. SCANTLEBURY. As far as we know, in April 1980, CSA informed UPO that \$223,000 had been confirmed as the unexpended Federal fund budget balance from CSA grants through September

30, 1977, and \$219,485 would be reprogrammed for UPO's grant. The remaining \$3,515 was to be returned to CSA.

CSA, however, has not resolved the question of how much of the \$1 million of UPO's economic development revolving fund is CSA funds and what portion of these may be excess.

Senator CHILES. Do you have anything more to tell us on the Detroit situation?

Mr. RASPEN. The work we did in Detroit was quite limited in relationship to some of the other places, such as Cleveland. Therefore, we have not identified too many problems.

CSA and HEW offices in Chicago, as part of their regionwide offices, have identified some excess funding authority and cash in the Detroit programs that may be reprogrammed or recouped. So HEW and CSA are following up.

Senator CHILES. In your last report on Detroit you were talking about one of the individuals that was drawing down two salaries. Do you know whether any corrective action was taken on that?

Mr. RASPEN. Yes. I will let John Dowell speak to that.

Mr. DOWELL. The corrective action that is currently being taken is the individual, as I understand it from talking to the FBI, has admitted that he did receive dual reimbursement. Under the pre-trial diversion, he is supposed to refund approximately \$5,800 and also be put on probation for a 1-year period.

Senator CHILES. Under the leasing arrangements whereby community organizations formed dummy corporations and rented space and reaped the profit from that venture, were any of the funds ever recovered to your knowledge?

Mr. SCANTLEBURY. Yes. CSA required that one leasing company return excessive rental fees. They got back \$27,814 of interest income. They have not established overall policies or regulations that apply specifically to the service corporations, even though CSA has acknowledged the need for them.

Senator CHILES. You mean they still haven't prohibited that practice from taking place?

Mr. SCANTLEBURY. No. They need to issue some regulations to control what can be done by service corporations if they are allowed to work with the CSA grantees.

Senator CHILES. GAO has testified about the situation in dual funding and irregular leasing arrangements and other abuses in the community development in Chicago. Has there been continuous Federal involvement either from the FBI or IG on that issue?

Mr. SCANTLEBURY. Mr. Raspen is up to date on that one.

Mr. RASPEN. The Department of Human Services and CSA officials have been investigating the Community Action agencies in Chicago. There are two of them out there.

In addition, some corrective measures have been taken, but the resolution of the process has not been complete. For example, DHS has not ruled on the legality of the corporation there. It has, however, approved a 2-year contract between the Community Action Agency and the leasing company after it received assurance that no other property will be sold during the contract period and that the \$85,000 proceeds from the sale of the buses, which we discussed previously, will be deposited in non-interest-bearing accounts.

I will continue on with everything that has happened in Chicago.
 Senator CHILES. Yes.

Mr. RASPEN. In regard to dual reimbursement, the Chicago Department of Human Services consider the offset of dual reimbursements against another claim. DHS has not established the validity of that claim. I think this needs to be done.

At the Community and Economic Development Association, neither DHS nor Agriculture have taken any action to determine the amount of dual reimbursement for food costs.

In regard to leftover grant funds, DHS reported to us that it had reprogramed \$5.5 million of leftover Head Start funds since 1979, including nearly \$2.5 million of the Department of Human Services. We believe there are additional funds there which we discussed previously that have not been reprogramed and that need to be.

Senator CHILES. How about giving me some minimal on that. I would like to follow that up with the agency. So if you will give me something on that.

Mr. RASPEN. Yes.

Senator CHILES. If a community-based agency acquires property in its own name, it is not able to charge interest to Federal grants and would be required to return any excess property or proceeds from the property sales to the Federal Government. Wouldn't that be correct?

Mr. RASPEN. Yes, that is correct.

Senator CHILES. In fact, that has happened and is probably still happening?

Mr. RASPEN. Let me see if I understand your question. If the Community Action Agency acquires property in its own name, it cannot charge interest to the Federal grant and any proceeds from its sale of property has to be returned to the Federal Government, yes.

Senator CHILES. So therefore, when they set up the dummy corporation, they are doing indirectly what we prohibit them from doing directly.

Mr. RASPEN. Yes. When a corporation is set up, the normal practice is to charge the Community Action Agency for the full payments, including interest; and as we saw in the case of Chicago, when the item was sold, the proceeds were not returned.

Senator CHILES. We want to thank you very much for your testimony and the work that you continue to do in this area. We want to follow you up on this very much.

Mr. SCANTLEBURY. Mr. Chairman, I would just like to inform you of one thing that might be of interest to you concerning the single audit. The joint financial management improvement program is going to set up an implementation group which we hope we are going to invite some of the Inspectors General to participate in. We are going to invite some of the CPA firms through the American Institute of CPA's who will do some of the auditing work—State auditors, local auditors—to try to work out some of the problems with the single audit.

Different States have different laws. This causes different problems. We are going to get a committee together to try to deal with

all of those problems so we can get the single audit implemented as quickly as possible.

Senator CHILES. I think that is very important. I really want to be kept informed on what goes on with that.

As I pointed out to OMB this morning, I am very impatient with this sort of pace. I recognize there are some problems. I was contemplating about whether we just needed to statutorily put that in. Maybe we should not do that if we think progress can be made in another way.

As the California people pointed out, I recognize there could be some problems in writing in the stone in which you cover everything with a single audit. But the concept no one can take issue with and no one has taken issue with. And I am delighted to see that the response we have had from the States and many of the recipients of the grants themselves are in favor.

Mr. SCANTLEBURY. There are more problems that came up than we had anticipated, but I think if you have a group of all of the interested parties working together, they can work out those problems.

Senator CHILES. I think they can, too. Thank you all very much.
[The prepared statement of Mr. Scantlebury follows:]

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
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STATEMENT OF

DONALD L. SCANTLEBURY, DIRECTOR

FINANCIAL AND GENERAL MANAGEMENT STUDIES DIVISION

BEFORE THE SUBCOMMITTEE ON FEDERAL

SPENDING PRACTICES AND OPEN GOVERNMENT

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

CONCERNING THE COMPREHENSIVE AUDIT AT

THE COUNCIL FOR ECONOMIC OPPORTUNITY

IN GREATER CLEVELAND

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our investigation into the allegations of fraud and abuse disclosed by the various audits of government programs operated by the Council for Economic Opportunities in Greater Cleveland and its subgrantees. With me are Robert Raspen of the Financial and General Management Studies Division and John Dowell and Joseph Stanziale of our Cleveland office.

On March 22, 1979, we testified before the Senate's Subcommittee on Labor, and Health, Education and Welfare, Committee on Appropriations, on the preliminary results of our review. We described instances of diverted and embezzled funds, improper loans, dual and excessive travel costs, and

improper credit card charges. We also reported internal control weaknesses at the Council's subgrantees, as well as inadequate documentation for and accountability over expenditures, dual reimbursements for food costs, and other areas of program abuse.

Since that testimony we have been analyzing these instances to determine whether breakdowns of internal controls permitted them to occur. We found that internal control breakdowns occurred at both the Council and the Federal agencies administering the programs.

Good internal controls are the most effective deterrent to fraud, embezzlement and related illegal acts. A system of internal controls in the broadest sense encompasses (1) safeguarding assets, (2) promoting accuracy and reliability in accounting and operating data and (3) assuring compliance with directives and laws. In the simplest form, internal controls are the body of checks and balances which organizations set up to spread work out in such a way that one person or function checks on what another person or function does. We found that the Council violated good internal controls. In fact, we found few checks and balances and that the accounting records and reports could not always be relied on because, in some cases they were used to help conceal fraud and abuse.

Today I would like to discuss the breakdowns of internal controls which permitted the fraud and abuse to occur and

the breakdowns of auditing procedures which permitted them to go undetected or uncorrected.

Diversion of funds

The diversion of Federal funds into three unrecorded savings accounts took place in 1973 and 1976. In 1973, the Council received \$974,000 for a grant that was previously cancelled and deposited the money into an interest-bearing savings account. Over the next 15 months the funds were transferred in increments to the Council's regular checking account. Again in 1976, the Council on six occasions deposited checks totaling \$852,000 into an interest-bearing savings account and after 9 to 31 days transferred the money to its regular checking account.

Neither the savings accounts nor the interest earned on them were recorded on the Council's books or reported to CSA. In fact, the Council's executive director, in July 1977, denied the existence of any savings account while, at that time, the Council had two such accounts.

An effective internal control system would have prevented the establishment of unrecorded bank accounts or at least would have disclosed their existence. An effective system would have separated the physical receipt and depositing of cash, the recording of cash receipts in the accounting records, and the receipt of bank statements. At the Council, these functions were controlled by one individual.

The auditors reviewing the CSA funds did not discover the diversion because they did not perform an audit procedure which would have alerted them to the diversions. This procedure is to confirm with CSA the amounts and dates of funds transferred to the Council. Such confirmation is required by CSA regulations and had it been performed, the auditors would have been unable to reconcile the checks with the dates and amounts of deposits shown on the bank statements and accounting records. Furthermore, the confirmation would have disclosed that CSA provided the Council with a \$974,000 check that was not entered in its accounting records. Also, had the auditors confirmed check payments when it made its audit for the year ended January 31, 1977, the 1976 diversion may have been disclosed.

CSA did not discover the diversion because it did not adequately analyze the auditor's report which showed that CSA owed the Council \$448,000. However, because of the unrecorded check, the Council actually owed CSA \$349,000. Had CSA analyzed the audit report, it would have been apparent that the Council's records were inaccurate and that the \$974,000 payment had not been recorded.

Embezzlement

As we previously testified, the former Finance Director was convicted of embezzling \$120,000 by depositing idle HEW funds into a personal savings account. He was able to do this because he had complete control over cash disbursements

and he used idle funds from unaudited accounts. An effective internal control system over cash disbursements could have prevented this embezzlement because it would have segregated duties so that one person would not have control over the entire transaction. But as I stated above there was not a proper segregation of duties at the Council.

The CPA firm auditing CSA funds recognized and reported a year before the embezzlement, that internal controls over disbursements were weak; however, neither CSA nor the Council took action to correct the problem until after the embezzlement was discovered. Specifically, the auditors reported that one person--the former finance director--had control over (1) payroll preparation; (2) operating the facsimile signature machine; (3) the supply of unused checks; and (4) distribution of checks. The auditors also reported that bank reconciliations were not timely and cash disbursements were not supported by documentation.

Improper loans

Over the past several years, the Council freely loaned money between Federal programs. Such loans are normally not allowable under agency guidelines. This practice resulted in Federal funds being used for purposes other than intended and may have been used to conceal shortages. A loan was used to conceal part of the \$120,000 embezzlement.

Neither the Council nor the Federal agencies know the extent of the loans. Nor do they know if all loans have been repaid.

Deloitte, Haskins & Sells, the public accounting firm now performing the single audit of the Council, is reviewing all loans and interfund transfers to determine (1) the need for such loans and transfers; (2) the purpose for which the funds were used; and (3) timing of the transactions relative to possible substitution to offset or conceal shortages in the program accounts to which the loans or transfers were made.

Since top Council officials were involved in transferring the funds between programs and accounts, no system of internal controls would have prevented the improper loans. However, the auditors on several occasions reported the unauthorized loans to HEW and CSA but neither agency acted to have the practice discontinued. The loans continued until January 1979.

Excess cash

In addition to the internal control breakdowns and the lack of followup on deficiencies reported in audits, one factor significantly contributed to the three instances of abuse and misuse of Federal funds which I just discussed. This factor is an excessive amount of Federal cash in the hands of the Council. The excessive cash held by the Council and other grantees results in the Treasury unnecessarily paying interest on borrowed funds. As you know, in recent months the Treasury has been paying record interest rates.

The Council was able to amass large cash balances because: (1) it drew down cash before it was needed; (2) the Federal agencies did not recoup funds in expired or terminated grant

accounts; and (3) the Council may have received dual reimbursement for certain costs. Some of the excess cash was embezzled, diverted into interest-bearing savings accounts, or loaned improperly to other programs. Failure of the Federal agencies to monitor cash balances contributed to the problem.

Federal policy requires grantees to maintain no more than a minimum of cash on hand. This has been defined by CSA as a 30-day supply and by HEW as a 3-day supply. On January 31, 1979, the Council reported that it held \$1.8 million of CSA funds on hand. Based upon average disbursements for the prior 6 months, this was 10 times its average monthly disbursement needs. Similarly, on that date, the Council reported to HEW that it had cash of \$312,000, or about \$120,000 more than its monthly disbursement rate for the prior 12 months.

The Council was able to accumulate large cash balances because it drew down funds before it needed them. In reviewing the quarterly financial reports to CSA, we noted that during the quarter ending October 31, 1978, the Council withdrew \$1.4 million and expended only \$502,000. Thus the Council withdrew nearly \$900,000 more than it needed during this quarter. Similarly, for the quarter ended April 30, 1979, the Council reported a balance of CSA cash of \$1.6 million. This occurred because the Council withdrew \$700,000 even though it had a \$1.8 million balance on hand at the beginning of the quarter. CSA related expenditures during

this quarter amounted to \$1.3 million. After we began questioning these high cash balances, the Council stopped the practice of withdrawing more cash than its disbursement needs. As of May 19, 1980, the Council had only \$136,000 of CSA cash on hand.

Had the Federal agencies reviewed the Council's quarterly financial reports, they would have identified the excessive cash balances. The Council was supposed to explain any large balances but did not. Since the quarterly reports show the cash on hand and disbursements made during the quarter, even a cursory review of the reports would have highlighted the excess cash position. HEW and CSA regional officials told us that they did not have the staff to review the reports.

Another factor contributing to excessive cash on hand is inactive program accounts. For example on April 30, 1979, the Council had over \$170,000 in 12 inactive bank accounts. Some of these accounts have been inactive for at least 4 years.

Still another source of excess funds arises from both Agriculture and HEW reimbursing food costs. Grantees such as the Council and its delegates can receive reimbursement for food and food-related costs from both agencies. While each agency can reimburse grantees for these costs, both should not reimburse for the same costs.

Although Agriculture is primarily responsible for reimbursing grantees for food-related costs, the Council was also

using HEW funds to purchase food. As a result, the Agriculture checking account usually had large cash balances. In this regard, we noted that 28 loans totaling \$450,000 were made from this account and, as of early 1979, \$42,000 of loans were still outstanding. As of September 1979, the Council had \$156,000 in the Agriculture bank account. Both the outstanding loans and large cash balances indicates that the Council has more cash than it needs.

As part of its single audit, Deloitte, Haskins & Sells is examining food reimbursements.

Other abuses

As discussed in previous testimony, we referred several cases of credit card and travel abuses to the Department of Justice; however, because of the small dollar amounts, Justice has taken no action. Our followup to determine if corrective action had been taken to prevent future occurrences showed that such action had not been taken. For example, our test of 25 transactions showed that 8 involve some sort of abuse of Federal funds. We referred the 8 cases to HEW's Inspector General who confirmed our findings and referred them to Justice. Again, Justice will not prosecute because of the small dollar amounts involved. This indicates to us that the Federal agencies must insist on strong internal controls and take administrative actions to recover Federal funds involved in minor cases of program abuse. In addition,

the Federal agencies must insist that individuals involved in such abuse are subject to administrative action.

I will now discuss other aspects of our work at the Council including prior audits of HEW programs, excess program authority and corrective measures.

PRIOR AUDITS OF HEW PROGRAMS

HEW has not accepted Ernst & Whinney's audit reports on the Council's HEW activities for the 3-years ended January 31, 1978, because of unresolved differences. The Chicago HEW audit staff has been attempting to reconcile the differences and has reviewed the Ernst & Whinney working papers. During this review the HEW auditors raised a number of questions about the audit work and as a result requested Deloitte, Haskins & Sells to do additional work during its audit of the Council including the following:

- analyze receipts and disbursements, including Agriculture reimbursements, to determine if all receipts were properly accounted for, disbursements were proper, and funds were promptly deposited and properly recorded,
- compare receipts and disbursements with approved budgets and final expenditure reports,
- review letter of credit withdrawals to determine if too much cash was withdrawn,
- analyze unused Federal funds at the beginning and end of each program year,

- audit in-kind contributions since the auditor's working papers do not indicate any audit of cost sharing was considered,
- audit additional transactions to the extent necessary to realistically determine the allowability and reasonableness of amounts claimed,
- review food costs since the auditor's working papers do not indicate that either the nutritional program or food costs were reviewed, and
- analyze accounts receivable for the 3-year period.

EXCESS PROGRAM AUTHORITY

The accumulation of excess cash at the Council, as well as other grantees around the country, occurs because the grantees receive too much funding authority in the first place. When Federal agencies approve grants, they approve letters of credit whereby, grantees can draw money to carry out the programs. However, at the end of the program year, the grantees can no longer spend the money unless they receive approval from the Federal agency. In Cleveland we found that the Council frequently drew down the entire amount of the grant even though actual expenditures were less than the grant. Thus, the Council would end the year with excess cash and with funding authority available for reprogramming.

The audit reports show that CSA and HEW funds available for reprogramming grew from \$656,000 in January 1975, to \$1.6 million

in January 1978. While audited data is not yet available, the balance as of January 1979 was probably even larger.

Until 1979, HEW and CSA permitted grantees with limited justification to add funds leftover from prior program years to funds authorized for the current year. For example, in early 1979, HEW authorized the Council to reprogram \$132,000 of unspent Head Start funds from 1972 through 1975 to the current program year.

Beginning in 1979, both CSA and HEW changed this procedure by requiring that grantees provide detailed justification for reprogramming funds and by deducting reprogrammed funds from the amount approved for the current program year. This approach appears fruitful. For example, in late 1979 the Council requested HEW approval for reprogramming \$1.7 million left over Head Start programs funds for years ended January 31, 1978 and 1979. The Council was later required to provide additional justification on the planned use of the funds. We were informed by a Council official that HEW will only approve \$1.1 million of the \$1.7 million requested.

We believe that these actions, coupled with increased attention to audit reports and quarterly financial statements, will reduce excess cash balances and lessen opportunities for fraud and abuse.

CORRECTIVE ACTIONS

The Federal agencies have taken other corrective actions which we believe will substantially improve conditions in Cleveland.

As you may recall in prior testimony, we pointed out that conditions at the Council were never fully disclosed because different public accounting firms were hired to audit individual programs, rather than one firm auditing all Council activities concurrently. Some programs were never audited. For many years the General Accounting Office has advocated single audits at organizations like the Council. Therefore, we believe that the engagement of Deloitte, Haskins & Sells to do the single audit at the Council is a major step forward. The audit, which covers the 4 year period ended January 31, 1979, started last November, is well underway and is expected to be completed in a few months. Since HEW will testify on the single audit, we are not providing details but will do so if you desire. We did note that ACTION had contracted for an audit of its program at the Council for \$2,400 but, after we brought the single audit to its attention, ACTION cancelled the audit.

Other actions in Cleveland include the following:

- the \$76,000 in the hidden savings account has been returned to CSA,
- the Council returned \$34,000 from inactive checking accounts to HEW,
- CSA withdrew \$500,000 in program authority from the Council,
- the cash held by the Council has been substantially reduced, and
- the Council's payroll procedures have been improved.

(Currently the FBI is investigating the extent of dual payments made to a Council official.)

Also, as a result of our work in Cleveland and other locations:

- CSA has initiated a nationwide review of draw downs under the letter of credit method of financing,
- HEW has begun an across the board survey of excess cash held by grantees,
- HEW added three people to its grants administration staff in the Chicago Region to review quarterly financial reports and to make field visits to grantees, and
- CSA regional personnel have now begun to review quarterly financial reports and audit reports, and have added this requirement to job descriptions.

This concludes my statement and I will try to answer any questions you may have.

Senator CHILES. At this time we will hear from a panel made up of Inspectors General from the various agencies: Frankie Muse Freeman, Inspector General of the Community Services Administration; Thomas F. McBride, Inspector General of the Department of Agriculture; Richard B. Lowe III, Acting Inspector General of the Department of Health and Human Services; and Ronald Goldstock, Acting Inspector General of the Department of Labor.

I don't know whether any of you have an opening statement that you feel required to give. If you do, or some summary, we would be glad to hear from them. I will put them all in the record. I really want to get into a panel discussion as soon as we can.

Ms. Freeman?

TESTIMONY OF FRANKIE MUSE FREEMAN, INSPECTOR GENERAL, COMMUNITY SERVICES ADMINISTRATION; THOMAS F. MCBRIDE, INSPECTOR GENERAL, DEPARTMENT OF AGRICULTURE; RICHARD B. LOWE III, ACTING INSPECTOR GENERAL, DEPARTMENT OF HEALTH AND HUMAN SERVICES; AND RONALD GOLDSTOCK, ACTING INSPECTOR GENERAL, DEPARTMENT OF LABOR, A PANEL

Ms. FREEMAN. Mr. Chairman, I have a statement that I would like to give in summary in response to some of the issues that were raised from the GAO report.

Senator CHILES. All right.

Ms. FREEMAN. Since our last hearing on October 19, 1979, the Inspector General's Office formally requested reports from CSA program officials setting forth the actions they took or planned to take to correct the deficiencies pointed out by GAO. CSA has taken action with respect to the major areas mentioned by GAO; that is, cash management, leasing organizations, dual reimbursements, control over fixed assets, and interproject loans.

With respect to cash management, in addition to reviewing the quarterly Federal cash transaction reports, the Controller's office has recently instituted a monthly computerized comparison of amounts actually drawn down against the balances that should exist in the grantee's letter of credit. In cases where a grantee is drawing down more funds than actually needed, the Controller's Office will send a letter to the grantee requesting justification for the drawdown and the return of any excess funds as well as interest earned on the funds.

With respect to leasing organizations, CSA will permit properly constituted service organizations which are substantially owned by community action agencies to do business with the CAA. New safeguards introduced by CSA should prevent abuse of this arrangement.

Briefly, the safeguards call for incorporation of the service organizations as a nonprofit corporation, residual interest in the assets inures to the low-income community, following standard Federal grantee procurement and personnel practices, same scrutiny of records as CAA records, and a yearly audit and accounting of financial status to the CAA board.

With respect to dual reimbursements, probably the best protective action that could be taken to control the problem of dual reimbursements is a single audit. CSA is implementing a new

application and reporting system which the Office of Inspector General will review for its effectiveness after it is in place.

On control over fixed assets, CSA has recently implemented OMB uniform requirements for property. Also, new monitoring procedures require field representatives to spot check controls over property during normal program monitoring visits. The grantee is required to submit an annual inventory to CSA and property control procedures are reviewed during the annual audit.

On the subject of interproject loans, this area has not been formally addressed but plans are pointing toward a mechanism for better control over these transactions rather than imposing an outright prohibition on their use. The plan would be to require the grantee to request permission from the CSA funding office prior to any transfers of cash from one agency's program to another agency's program. The grantee would also be required to justify the need for the transfer and provide assurance that the program receiving the loan will be funded by another Federal or State agency.

Obviously one of the better control procedures over these types of loans is the single audit which would track these cash transactions.

During the hearings in October, it became obvious because of repeated deficiencies year after year at some grantee locations that there was a need to follow up on corrective actions said to be taken by grantees and program officials. To fulfill this need, the Inspector General's Office has prepared a program for following up on corrective actions taken by program officials in response to observations of deficiencies reported in audits.

Our objective is to assure that corrective action that was stated to be taken actually was taken by the grantee or by the CSA official in the case of internal reports. In addition, we have initiated a new reporting system for internal reports. We now address the report to the Director of CSA with a copy to the appropriate program official and we request a response from the Director within 30 days.

As noted above, several of the problems reported by GAO would have been discovered or the chances of discovery would have increased had a single audit of all Federal funds been conducted.

On May 15, 1979, the Director of CSA requested the Director, Office of Management and Budget, to consider granting audit cognizance over community action agencies to the Community Services Administration.

Since that time, there have been informal discussions with OMB officials, and it appears that CSA's suggested cognizance arrangement is favorable to OMB. However, at this time OMB is deeply involved in setting up audit cognizant arrangements for State and local grant recipients as required by OMB Circular A-102. We believe, however, that the general approach to cognizance and to the single audit in A-102 will also prevail for OMB Circular A-110 which applies to private nonprofit organizations which comprise the major portion of CSA grant recipients.

In the interim, until compliance guidelines and OMB Circular A-110 have been completed or appropriately revised, CSA has attempted to use its audit resources more efficiently and has been engaged in 46 single audits during each of the past 2 years. In

addition, CSA has been involved in coordinating other single audits of multifunded community action agencies which are currently in process. CSA has also arranged with other Federal agencies for cross-service audits.

Thank you, Mr. Chairman. I just wanted to put into the record our response to the specific statements.

Senator CHILES. I will hold my questions to address the full panel.

Mr. McBride, do you have some opening remarks?

Mr. McBRIDE. Yes. I would request, Mr. Chairman, that my statement be entered into the record.

Senator CHILES. Surely.

Mr. McBRIDE. I will have some comments to make which are not so much a summary of the statement as issues which apparently are of great concern to the committee.

First off, I would like to note my appreciation for the responsiveness of the committee. I submitted a semiannual report last week urging close congressional oversight of the process of implementing A-102. The hearing this week is a quicker response than I had anticipated.

I have been very deeply concerned about the problem of the single audit policy and much more concerned about what I saw as some of the real world obstacles and pitfalls in implementation. Indeed, I wrote an article on the subject which I provided to the staff. I have also had a number of conversations with John Lordan and John White, and others who are likewise concerned.

Without dwelling on the problems, I would simply like to point out that the single audit concept contemplated by A-102 is going to be very difficult and extremely time consuming to carry out, or to carry out effectively.

The major problem that I see is that you are dealing with grant-ee-obtained audits. The problem of audit quality and coverage is going to be an acute one. That is the heart of the matter. That is where fraud and waste are either found or not found.

I think the system for quality control, for training of these contract auditors, for oversight of their work, for action in the instance of substandard work, by the Federal agencies, is going to be a critical problem. I don't see as yet any structure set up which leads to an orderly implementation of A-102 or A-110, which is the circular which would cover the community action agencies. I think that is a profound concern.

I also think there are many, many legislative issues that will be byproducts of the implementation of the single audit process. We have conflicting audit requirements in much of the legislation that now exists. Indeed, there are bills before this body which would add more inconsistent single grant audit requirements as opposed to total entity audit requirements. We will be commenting on those.

I think some structure for implementation needs to be established. Then we could analyze those conflicting requirements and get back to the Congress with recommendations for the amendments, changes, and refinements that are necessary.

The other major problem I see is funding. That was touched on by the deputy controller of the State of California. That is going to be a very critical problem.

As an Inspector General, I am extremely concerned that we not move enthusiastically into theoretical single audit coverage without backup systems to assure that they are really uncovering the fraud and waste that are there.

I welcome Mr. Scantlebury's comments on implementation under the rubric of the joint financial management improvement program. That might be a way to go. I myself have advocated that the Executive Group to Combat Fraud and Waste should be the umbrella group for implementation and that a steering committee composed of at least those Inspectors General whose agencies have the major grant programs and adequate staff should be set up very, very soon.

It is going to take, in my estimate, 3 to 5 years to really see widespread, national implementation of the single audit approach.

I think it is important to note the difference between the A-102 single audit and the joint IG audit.

As you are aware, I have been on detail to the executive group working on inter-IG projects, including those with single audit concepts.

The joint IG task forces, whether they involve work done by Federal auditors from several departments or auditing using a common contractor as in Cleveland, are very effective but they are rather ad hoc measures. They depend pretty much on IG resources and, of course, you have wide variance. If you are looking at the community action agencies, I believe Ms. Freeman has about 28 auditors on her staff, and they are looking at almost 900 community action agencies. Trying to cover them with a Federal inter-IG task force approach, with present resources, will simply not work. We are at best able to audit the more flagrant cases now. It is important to recognize that Ms. Freeman, with our cooperation and other agencies, recently launched this approach.

A-102 does not contemplate joint Federal audits. What it contemplates is grantee-obtained single audits. That adds a whole new dimension of problems.

In the community action area, Agriculture's role is primarily in the child care feeding program. That program represents, relatively speaking, a small part of the community action agency picture. In some there are no USDA funds. In some day care centers in Cleveland they have, relatively speaking, a small percentage of the total Federal funds.

We, however, are very concerned about the child care feeding program both in terms of single audit and dual reimbursement. One of the inter-IG projects which I developed for the executive group is a joint effort with Mr. Lowe of the Department of Health and Human Services in which we will jointly conduct a national program audit looking at the very specific issue of dual funding. Presumably legislative recommendations can come out of this endeavor to eliminate the potential which has been proven to exist for dual reimbursement for the same feeding costs.

We are also, within USDA, doing a national program audit of the child care feeding program itself, looking not only at dual funding but also at other problems. There are lots of problems we come up with. One of the things in connection with the single audit is that you may not have a consolidated financial statement of these com-

munity action agencies. So even with the best reporting systems, you are still getting fragmented reporting. It is extremely hard from looking at what is reported to Agriculture to get any picture, or any relevant picture, of the total fund status. You are dealing with agencies that may have 40 separate grant accounts and no consolidated financial statement.

I simply wanted to point out that in addressing these major issues, and particularly the single audit issue, continuing congressional dialog with OMB and the Executive Group To Combat Fraud and Waste and the IG's is going to be essential to make sure we have a system that works and that there are realistic expectations all around as to both the complexity of the task and the time which will be required before we have what we view as an adequate audit coverage of the thousands of grantee organizations that are out there around the country.

I have no further comments at this point.

Senator CHILES. Fine.

Mr. Lowe?

Mr. LOWE. Yes, Mr. Chairman, I also would like to submit my entire statement for the record.

Senator CHILES. It will be included, following your testimony.

Mr. LOWE. I do have some brief remarks to summarize our actions and the Department's actions since the matter was brought to our attention in March of 1979.

As you know, Mr. Chairman, most of the problems identified by you included excessive amounts of Federal cash in the hands of grantees, leading to embezzlement and diversion of funds in some cases; dual reimbursement to grantees for the same expenditures by different Federal agencies, such as Agriculture and HHS; lost, stolen or misappropriated fixed assets ranging from lawnmowers to automobiles; large loans between projects funded by HHS, CSA, Agriculture, and the Labor Department; and a variety of other abuses involving unauthorized and excessive project expenditures.

In addition, contributing to these situations is the piecemeal, uncoordinated grant-by-grant audits by the various Federal agencies involved.

I would like to report to you some of the things which the Inspector General's office has accomplished and also report to you some of the actions taken by the Department itself, notably the Office of Human Development Services.

Following your hearings, my office and other offices in the Department began taking certain steps. Among those, the Office of Inspector General intensified the audit and investigative attention on several community action agencies, including the following specific actions:

A special comprehensive audit of the Cleveland council was arranged with CSA, Agriculture, Labor, and other Federal agencies.

We continued active criminal investigations and opened new cases where illegality was indicated in the operations of community action agencies. I am prepared to give you further detail in terms of the investigative effort.

We took steps to strengthen non-Federal auditing of HHS funds at the community action agencies.

We established courses to instruct non-Federal auditors on how to audit Head Start grants. We now require each non-Federal audit report to be screened within 5 days of receipt to identify matters needing prompt attention, such as apparent program abuse.

My office has also acted to put the single audit concept into operation insofar as possible within our existing authority. To extend the single audit concept, the Office of Inspector General Audit Agency, OHDS, and CSA are working together on arranging combined audits of Head Start and CSA funds at community action agencies.

Although some technical problems remain to be solved, we have agreed to instruct grantees to have combined audits performed. We intend to make the combined audit our standard approach for examining community action agencies which receive Head Start funds—at least until the true single audit is in operation for community action agencies.

As was reported this morning, the OMB circular requiring the single audit approach only deals with the State and local agencies and has not yet been as fully implemented at the nonprofit grantee level.

The Department has also taken the following steps, Mr. Chairman:

The Head Start program managers in the Office of Human Development Services analyzed funding records, identified carryover balances, and recommended adjustments of excess funding.

Accounting staff under the Assistant Secretary for Management and Budget have reviewed the records on all open Head Start grants and are working with OHDS to verify the funding status of each grant.

Accounting staffs are beginning an analysis of the payment methods in use for Head Start. Grantees obtain Federal cash either by receiving monthly Treasury checks or by drawing more frequently under a letter of credit. This analysis should result in increased use of the more efficient letter-of-credit method and decreased use of the check-payment method. That was also discussed earlier this morning.

To encourage more frequent and timely cash withdrawals, larger numbers of withdrawal forms are being sent to each grantee funded by letter of credit. In the past, the limited number of withdrawal forms provided caused many letter-of-credit holders to draw only monthly and hold excess cash rather than draw weekly or biweekly based on actual cash needs.

The basis of recording expenditures in the Department's accounting records has been changed. Expenditures reported in current periods will now be charged to the award for the current period rather than to the oldest open award. This basis should more effectively identify where significant unliquidated obligations exist and permit analysis to determine the action necessary.

OHDS has established more specific policies on dealing with excessive carryover balances and is recapturing \$8 million in outstanding carryover balances from the Head Start grantees across the country. These moneys will be returned to the Treasury in fiscal year 1980. OHDS has also established a specific policy directed toward preventing the accumulation of large carryover balances

by Head Start grantees. This is included in the HDS staff manual for grants offices and will be incorporated into the grants administration manual for grantees this summer.

The policy provides that grantees will not be permitted to have substantial unobligated balances available from past funding. Therefore, except in unusual and justified circumstances, action will be taken to reduce the obligation authority available when the reported unobligated balance exceeds 20 percent of the amount authorized—10 percent for authorizations in excess of \$1 million. In cases where the balance is less than 20 percent, HDS may exercise the option to make an offset or deduction from a continuation award or approve the use of the balance by the grantee as a one-time expenditure for special needs.

OHDS has initiated a major effort to review the fiscal administrative system of all Head Start grantees and their delegate agencies over a 3-year period beginning in fiscal year 1980. The purpose of this onsite review is to determine the extent to which Head Start grantees and the delegate agencies are operating programs consistent with sound financial management practices and prescribed departmental policies and procedures. Followup training and technical assistance will be provided to grantees in order to correct deficiencies noted in the reviews.

Since March of 1980, 65 Head Start grantees have received a fiscal administrative review. In fiscal year 1981, and in subsequent years, the OHDS financial management initiative calls for a complete onsite review of the approximately 1,139 Head Start grantees. This would entail an onsite review of one-third of the grantees annually.

Finally, enrollment shortfalls also may have contributed significantly to the growth of excessive balances. OHDS has now published regulations on recruitment, enrollment, maintenance of enrollment, and attendance. These regulations provide for OHDS monitoring of enrollment levels and action to reduce funding levels where a grantee proves unable to maintain funded enrollment levels.

That concludes the brief portion of my statement, Mr. Chairman. Thank you.

Senator CHILES. Thank you, sir.

Mr. Goldstock?

Mr. GOLDSTOCK. Good afternoon. I have nothing really to add to the statement, except that you might be interested to know that in addition to the Controller study of cash management that was alluded to this morning by I believe people from OMB, the Office of Audit within the Inspector General's office in Labor is conducting a cash management review of procedures in CETA prime and sub-sponsors. When we have that completed, we will be happy to share the results with you.

Senator CHILES. We would like to see that.

Mrs. Freeman, listening to some of the testimony this morning from the GAO in regard to the Cleveland situation and some of the areas they were looking at in regard to CSA, problems in that area with the community organization there, how are we going to—I ask this really to all of the panel, but let's let you start off—how are we going to get from the situation where quarterly reports are not

looked at or internal controls that are required by CSA or by other agencies that require certain provisions for the way bank accounts are kept or other matters are kept are not complied with, and audit reports show they are not complied with, or some other report, but then the Administrator, or whoever is supposed to be checking that, doesn't follow up and doesn't check on it; this idea again of no responsibility with the Administrator, whoever he is, the manager, who should be seeing that those reports are correct. How are we going to get some kind of accountability in the system?

Ms. FREEMAN. Mr. Chairman, at CSA there is now and has been instituted a program of accountability. As the question was raised about the official who signs off, who fails to do this, it is now written into the job description for each regional director, I am informed, that that is part of his performance, that is an area where that individual will be evaluated.

I cannot tell you exactly what is being done at the personnel level because I believe that the program people would be the most appropriate people to respond to that. However, we do agree that there has to be accountability and that we, CSA, and other Federal agencies need to at least assure that when an action that should be taken is not taken, that there would be a penalty as a result of that.

All I could say is certainly some corrective action has been taken. This happened, as you know, some time ago. We have started from the beginning—

Senator CHILES. I understand that. I am not trying to start post-era morality. I understand that is always so. I see that problem occur many times, you go along and rules are one way and suddenly in the middle of the ballgame you change the rules and you go out and chop some hands off or heads off because of that. When the rules have been as clear as they have been and then the flagrant violation, and the fact that nobody kept account, I am not trying to necessarily go back to get some heads, but I certainly want it to be from the ballgame that we are playing in now. When we went into the new Personnel Act, when we went into the IG concept, when we have gone into everything, all of the rhetoric we have talked about, stopping fraud, abuse, waste, mismanagement in the Federal Government, everybody out there should know that we are playing with some different rules now.

I want to know in effect how the IG function is going to help begin to name and pinpoint the people in responsibility and how the Congress is going to know how that is done so that we in turn can demand some accountability; because I think until that becomes very clear that that is going to be done, we again can have the best controls in the world, the best internal controls or the best quarterly reports or the best single audit, but if nobody is going to follow up, we still are spinning our wheels.

Ms. FREEMAN. We have initiated a very effective—which we hope will be effective—followup program. We will also identify those individuals or those offices that we believe are part of the problem.

But again, you of course recognize, Mr. Chairman, that we are in a position where we have to make the best use of what we call very, very limited resources. We cannot do many of the things that

we know within the mission of the office of Inspector General, but we are doing the best we can with what we have.

Senator CHILES. I understand that. But in addition to that reporting and that followup, I think somehow that reporting has to come to the Congress. I know you make your annual report or your semiannual report. But we have to be informed of where you have made these requirements so that we can oversight and determine whether those requirements are being met or not.

I think if we don't have that information—I am putting you on notice right now, all of you, that I want that kind of information; because in the oversight function, one, I want to know that you are doing that and that you are making those requirements; and two, I want to be able to follow up with the agencies to see what they are doing and how they are handling the cases, that there is something going to be done.

Mr. Lowe?

Mr. LOWE. Mr. Chairman, I really think the mechanism may exist already. Congress has mandated that we produce an annual report and further requires us to report to you, to the Congress, those areas in the Department in which we have pointed out needed improvements to which the Department has not responded. I think that that is a specific requirement of us. So certainly within that area it can be further broken down into greater detail if that is necessary.

Senator CHILES. I think that is what I am saying, in effect, that we need enough specification. I don't think this is sufficient to say we accept certain responsibilities, ask the Department to say corrective action is going to be taken, and we are disappointed with the corrective action that has been taken. That kind of report crossing my desk or our staff's doesn't give me much to go on.

You tell me that there is a Cleveland situation and based on the Cleveland situation, the annual report, the quarterly reports were not reviewed or internal controls were not kept. They were disclosed by reports and/or the audit and that no action was taken and no corrective action was taken on the part of the Administrator who was in control and responsible for that program.

Then I think we are in a position to look down at the agency and say what has happened? Why haven't you taken some action? Why isn't the requirement kept?

Going again over the situation that has been raised where the Justice Department has not seen fit to prosecute in some of the abuses that came out of the Cleveland situation and administrative action has been requested, have you as Inspector General made that request or is that just GAO?

Ms. FREEMAN. Mr. Chairman, we have provided you with the up-to-date summary of the action, corrective action, that was taken. In that report which we provided you this morning, the required action has been completed. The grantee was told to refund the interest and explain the source of funds in inactive accounts. \$75,000 was returned to CSA so far.

Senator CHILES. No. That is the grantee's action. I am talking about now individuals who there was sufficient information there to charge those people with crimes, but the Justice Department didn't see fit to prosecute them because it wasn't severe enough or

they didn't feel like it warranted their resources, the use of their resources. I am trying to determine have administrative penalties been provided in that regard?

Ms. FREEMAN. Mr. Chairman, may I provide that to the subcommittee, because I don't have it with me.

Senator CHILES. Yes, ma'am.

Senator CHILES. I think again, to the rest of you, I want to determine, what do we do in this situation? I am sure many times—we saw it in a lot of the GSA investigations—you are dealing with matters that while they are clearly culpable and there is sufficient proof there, the U.S. attorney is going to say, "I am not going to spend my resources. I have too many cases pending that are of greater magnitude." So he refuses to prosecute.

How do we try to see that people out there know that there is going to be some kind of accounting required?

Mr. McBRIDE. I would like to observe, Mr. Chairman, you are dealing with two populations. First there are the Federal employees, and problems with them are, relatively speaking, quite easy to deal with. I think the IG followup in many cases of employee misconduct that may or may not rise to the criminal level is probably pretty good and that agency support of OIG recommendations in terms of discipline or other actions short of criminal prosecution has been good, at least in the Department of Agriculture.

When you are dealing with grantees or other third party employees it is somewhat more complex. We have had some experiences, for example, in the rural electric coops which are independently organized cooperatives receiving substantial subsidized loan benefits from the Department of Agriculture. As a condition of loans we have imposed requirements such as the dismissal or the reconstitution of a board of directors or that sort of thing. But that is somewhat more difficult because you are working through an indirect mechanism like the loan contract, the grant requirement, or whatever it may be to impose a specific requirement on the grantee. I advocate it, obviously.

Senator CHILES. I think it is going to be a necessity to do something like that, because if you don't, in many instances what you are talking about is one of the principles in the community-based organization, or whatever nature it is, he is not going to go discipline himself.

Mr. McBRIDE. It is quite clear that further grant funds then should be conditioned on getting a new director or a new board of directors or whatever the situation there requires.

Mr. LOWE. My comments were going to be very close to Mr. McBride's. What we have done in many instances was to enter into what we called limitation agreements with some schools, most notably the college down in Dallas. There we imposed standards upon the university itself, the college itself, concerning who would be employed to administer funds. In these cases, we had been responsible for the indictment of the previous officials.

These kinds of things, of course, can be done.

It should be pointed out that with the myriad of grantees we have, especially in our social action programs, to impose and follow up on limitation agreements can be extremely time consuming and can be, well, expensive. But I think that if in the initiating con-

tract or grant award we had imposed some clause indicating that any individuals found to have abused the system or convicted of abusing the system would of necessity have to be terminated from further operations in the program, and failure to do so would mean cessation of followup grants; I think that can be done. It is certainly an area to explore within the Department.

Mr. GOLDSTOCK. It seems to me it is a difficult problem. It depends on whom you are dealing with. In many cases what we have tried to do is involve local law enforcement, which doesn't have some of the calendar problems that the U.S. attorneys have.

Senator CHILES. I think that is tremendously important because I think a lot of times that can be done.

Mr. GOLDSTOCK. Yes; in many cases they are very interested in doing that. It also puts accountability on local government, which is in fact getting the money.

Another thing that might be done would be to use, as well as criminal remedies, civil remedies. I would be very careful about doing what I am going to suggest, but I think in appropriate circumstances it could be done. The Rico Statute, for example, would allow you under certain circumstances to recover treble damages. Something like that might have a far greater effect as a deterrent than anything else.

Senator CHILES. Especially when you are dealing with organizations.

Mr. GOLDSTOCK. That is right. That is when Rico would come into play.

Senator CHILES. That is what I said, as opposed to an individual. When you are dealing with an organization, you certainly would get their attention.

Mr. GOLDSTOCK. That is right. And the individuals who run that organization would be personally responsible for the treble damages. As I say, it shouldn't be used in inappropriate circumstances, but I think there are times when it can be used quite effectively.

Mr. McBRIDE. Could I add an observation, Mr. Chairman?

In working on the inter-IG projects, one of the issues we have been looking at is debarment systems and practices in the procurement area, in the housing area, and in the grantee area. My expectation is that the Executive Group Against Fraud and Waste will probably be developing some improved information sharing mechanism so that the problem grantees can be better identified and we have at least an OIG network of better interchange so that we can take concerted multiagency actions in some of these cases. It is akin to what we find in the procurement area with the population of grantees.

Senator CHILES. I think that would be very helpful.

Mrs. Freeman, I will start off by asking you this question and then the rest of the people. Do you have the capability to find out how much excess funds are in the agencies which CSA now funds?

Ms. FREEMAN. May I ask Mr. Kratz to answer that?

Senator CHILES. Yes, ma'am.

Mr. KRATZ. I don't know that. I think we would have total capability to determine the excess funds in all of our Community Action agencies or at our other grantees.

One way I guess we could attempt would be a review of audit reports which would indicate the total funds available and those which are unexpended. That would be I think a huge task, though, for the staff we have.

Senator CHILES. I am not interested in it to just have a total number that could be used some way. I am interested in it to determine how we really get a handle on Community Action agencies agency by agency in effect for each of these respective things: how much have you got out there; How much can we get back; and how much can we withhold on further funding. That is my interest, not what the magic number or total is.

Mr. KRATZ. I think in the agencies, especially in the Controller's area, they should take the action to require grantees to submit the quarterly reports and that the system in the agency should handle those reports, get them into some form, into the computer, so that the data could be issued and compared, or comparisons could be made with what the drawdowns made by the grantees are, make that comparison. I think our Controller's office right now is attempting to initiate that system. In fact, I think letters have already been sent out to several grantees indicating where their cash position is in excess and they are asking them to return the amount of cash in excess of what they had claimed they are drawing down.

So I think there is an effort in CSA to determine what is out there in the way of excess balances. It is a start.

Mr. McBRIDE. I have some skepticism because of the system inadequacies where you are dealing with 40 to 50 separate grant accounts and 40 to 50 separate annual or semiannual, quarterly, or monthly reports and no consolidated financial statement. Even the best reporting system under the present method is going to be very flawed.

I am somewhat convinced from our experience that actual hands-on single audit, total auditing work is going to be necessary to really get a handle on what is the actual unexpended cash.

Another problem is that we are usually going on is the accrual reporting system. So they may report accruals that may be payables and warp the whole picture, so you don't know what they actually spent.

So there are a lot of technical wrinkles that make it extremely hard to get at the bottom of this short of actual on-site total auditing. Then when we get on-site, you don't have a consolidated statement. You are auditing 40 to 50 statements.

Senator CHILES. Well, are you pointing out, should we require a consolidated financial statement?

Mr. McBRIDE. I think that is one of the things about single audit implementation that lies down the road. I think that is where we have to pay attention to the nuts and bolts. I don't see how we can expect to do an entity audit when you don't have the funds on one set of books.

Senator CHILES. Certainly you would hope at the end of that you would have a consolidated statement at the end of the process.

Mr. McBRIDE. Yes; I expect we are going to find out as we go along that CPA's are going to throw up their hands and come back

and say, "We couldn't give you a total balance sheet because the records were not constructed to provide that kind of answer."

Senator CHILES. Mr. McBride, I have a few more questions to ask of you, but in the interest of time I will ask you to answer them in writing after the hearing.

Mr. McBRIDE. Fine.

[The questions and responses follow:]

RESPONSES TO WRITTEN QUESTIONS FROM SENATOR CHILES

Question. I think one of the problems that USDA faces is the fact that most of your field personnel are not trained as banking or loan experts but rather they are agricultural experts. Would you agree to that assessment?

Answer. Information from our current analysis of FmHA personnel procedures shows that in 1979 of the 3,731 professional level field employees 1,047 were classified as loan specialists and 2,684 were classified as agricultural specialists. Furthermore, the majority of the loan specialists positions were filled by promoting agricultural specialists into those positions.

Of the 500 entry level hires in professional positions during fiscal year 1979, 496 were filled by individuals classified as agricultural specialists. Four were loan specialists. This is not to suggest that individuals meeting the requirements of an agricultural specialist cannot successfully analyze and monitor various program loans. In fact, the job description for agricultural specialists states the work primarily involves the application of professional knowledge in the general field of agriculture, but also requires a good understanding of credit and the facilities and services required in rural community development. The primary problem, however, is that loan programs such as Community Facilities and Business and Industrial Development are far more complex than those programs normally used by farmers and are frequently beyond the scope of expertise and experience of many FmHA employees. The nonfarm programs now represent 47 percent of the loan fund administered by FmHA.

Question. The fact that you have no central control system means that the program has probably been ripped off by people who get different projects in different States, is that right?

Answer. It is true that we have some cases under investigation that involve borrowers who have gotten loans in different states. Right now FmHA does not have the capability to determine whether a problem borrower is involved in projects in other States.

FmHA is taking steps to correct this situation. The agency is completely revising its project tracking system. The new system will be able to monitor the performance of all borrowers and identify any loans in other States made to a borrower with a problem identified in one State. The agency hopes to implement this change by the end of September 1980.

Senator CHILES. Mr. Lowe?

Mr. LOWE. I would agree, Mr. Chairman. As I noted in my opening statement, in terms of the actions taken by the Department, two such actions concerning the issue raised involved the accounting staff under the Assistant Secretary of Management and Budget reviewing the work and working with HDS to verify the funding status of the grants. This is along the lines of what you were referring to. How do you get a handle at any given time on the process and how does the Department know whether or not there is a large carryover balance at any particular time? You can only do that by reviewing all the records. When we consider all grants to a particular entity, it involves not just my Department, the Department of Health and Human Services, but also the Department of Agriculture and CSA. So obviously some improvement or innovation in terms of reporting requirements has to be looked at.

First, I think initially, the responsibility lies with each individual Department in terms of its constant oversight of those funds which

it metes out and adherence to the standards which it requires. Second, there must be followup checks on grantees.

Third, the responsibility is on the auditors, either Federal auditors or contractual auditors, to determine if in fact the i's are dotted and the t's are crossed.

Senator CHILES. Mr. Goldstock, do you have anything to add to that?

Mr. GOLDSTOCK. Just briefly. I mentioned before, we are in the middle of a review of cash management procedures. We are concerned not only about the prime sponsors in CETA but the subs as well. That is, in fact, where a lot of the money may be. We will have an answer for you as soon as we complete that review.

Senator CHILES. Mrs. Freeman, I had a number of letters from people who saw some news information about the use of CSA funds in the establishment of a complex microwave system with a farm worker service center in Keene, Calif. Your office has been looking at that case, have you not? Have you got any report on that?

Ms. FREEMAN. Mr. Chairman, I have just signed that report and transmitted it to the Director. Under our policy, the Director has an opportunity for comments within 30 days. So I could say yes, I do have a report, but with the caveat that I just gave.

Senator CHILES. That wouldn't prohibit us from getting a copy of that report, would it? There is nothing in your policy that I know of that says you can't give us a copy of it.

Ms. FREEMAN. You are right, sir.

Senator CHILES. Thank you. [Laughter.] I was hoping I would get that answer. I would like to have that. Then I will be glad to have a copy of the Director's comments in 30 days.

I have a number of other questions I would like to ask you, and some of them we will submit for the record. But our morning has pretty well gone into the afternoon now.

I thank you for your appearance and for your continuing follow-up in this area. I recognize that there are problems in the single accounting system. I think that what GAO has mentioned today and perhaps what you have mentioned of bringing in the Fraud and Abuse Task Force may be necessary, too. I am still convinced that the concept we are talking about is sound, and the only way we are going to get the answer to a lot of these problems we are talking about is to go forward with it. I hope we don't try to find everything that keeps us from going forward and wait until we have the votes out before we go forward. There are enough problems in what we have now. I am willing to have a few problems in the single audit system and experience some problems with that rather than try to go along the way that we have been going in the past and having tremendous problems with that.

We have heard some more stories today about bank accounts, not only concerning agencies and directors, again seeing that excess funds have become sources of profit for Community Action Agency personnel, the unexplained use of property purchased by Federal funds and maintained by Federal funds but ultimately serving only for private property. I think that single audits certainly is an answer and that we need to go forward, as I said, as far as we possibly can. My present inclination is to put some kind of language in the appropriations bills as they come through involving

the actions of the agencies that are funding these Community Action agencies which would require some kind of joint audits and that these joint audits be performed under the direction of OMB. I think that we have just got to go forward on this.

Mr. Goldstock and Mr. Lowe, I have questions for you that I will have produced for the record.

I thank you very much for your appearance here today.

[The prepared statements of the panel members, and responses to written questions, follow:]

PREPARED STATEMENT OF FRANKIE MUSE FREEMAN, INSPECTOR GENERAL,
COMMUNITY SERVICES ADMINISTRATION

My name is Frankie Muse Freeman, Inspector General, at the Community Services Administration. I appreciate the opportunity to appear today to provide you and your subcommittee with a summary of actions taken by the Community Services Administration in response to observations made by the General Accounting Office as a result of its reviews at nine Community Action Agencies funded by CSA.

Since our last hearing on October 19, 1979, the Inspector General's office formally requested reports from CSA program officials setting forth the actions they took or planned to take to correct the deficiencies pointed out by GAO. CSA has taken action with respect to the major areas mentioned by GAO, i.e., Cash Management, Leasing Organizations, Dual Reimbursements, Control Over Fixed Assets, and Interproject Loans.

Cash Management

CSA's policy is to comply with Treasury Regulations and its policy for making payments to grantees is outlined in CSA Instruction 6800-10. In addition to reviewing the Quarterly Federal Cash Transactions Reports (SF-272), the Controller's office has recently instituted a monthly computerized comparison of amounts actually drawn down against the balances that should exist in the grantee's letter of credit. In cases where a grantee is drawing down more funds than actually needed, the Controller's office will send a letter to the grantee requesting justification for the drawdown and the return of any excess funds as well as interest earned on the funds.

Leasing Organizations

CSA will permit properly constituted service organizations which are substantially owned by community action agencies to do business with the CAA. New safeguards introduced by CSA should prevent abuse of this arrangement. Briefly, the safeguards call for incorporation of the service organizations as a non-profit corporation, residual interest in the assets inures to the low income community, following standard Federal grantee procurement and personnel practices, same scrutiny of records as CAA records, and a yearly audit and accounting of financial status to the CAA board.

Dual Reimbursements

Probably the best protective action that could be taken to control the problem of dual reimbursements is a single audit. Another approach is to require standardized performance reporting and application procedures by the grantees. As long as one agency wants to know how many meals were served by a project and another agency how many senior citizens participated, and yet another agency, how many miles were travelled to transport seniors to a funding site, no agency will have the information needed to know whether its money is being spent effectively. CSA is implementing a new application and reporting system which we will review for effectiveness after it is in place.

Control Over Fixed Assets

CSA has recently implemented OMB uniform requirements for property. Also, new monitoring procedures require field representatives to spot check controls over property during normal program monitoring visits. The grantee is required to submit an annual inventory to CSA and property control procedures are reviewed during the annual audit.

Interproject Loans

This area has not been formally addressed but plans are pending toward a restriction for better control over these transactions rather than trusting an outright prohibition on their use. The plan would be to require the grantee to request permission from the CSA funding office prior to any transfers of cash from one agency's program to another agency's program. The grantee would also be required to justify the need for the transfer and provide assurance that the program receiving the loan will be funded by another federal or state agency.

Obviously, one of the better control procedures over these types of loans is the single audit which would track these cash transactions.

During the hearings in October, it became obvious because of repeated deficiencies year-after-year at some grantee locations that there was a need to follow-up on corrective actions said to be taken by grantees and program officials. In Fairfax this week, the Inspector General's office has prepared a document for following up on corrective actions taken by grantees effectively by reviewing the effectiveness of deficiencies identified in audits. The document is to assure that corrective action that was claimed to be taken actually was taken by the grantee, or by the CDA official in the case of indirect recipients. In addition, we have reviewed a new monitoring system for treatment centers. As now address the report to the Inspector of CDA gives a copy to the appropriate program official and an annual a response from the

Director within 30 days.

As noted above, several of the problems reported by GAO would have been discovered or the chances of discovery would have increased had a single audit of all federal funds been conducted.

On May 15, 1979, the Director of CSA requested the Director, Office of Management and Budget, to consider granting audit cognizance over Community Action Agencies (CSA grantees) to the Community Services Administration. Since that time, there have been informal discussions with OMB officials, and it appears that CSA's suggested cognizance arrangement is favorable to OMB. However, at this time OMB is deeply involved in setting up audit cognizant arrangements for state and local grant recipients as required by OMB Circular A-102. We believe, however, that the general approach to cognizance and to the single audit in A-102 will also prevail for OMB Circular A-110 which applies to private non-profit organizations which comprise the major portion of CSA grant recipients.

In the interim until compliance guidelines and OMB Circular A-110 have been completed or appropriately revised, CSA has attempted to use its audit resources more efficiently and have been engaged in 80 single audits during each of the past two years. In addition, CSA has been involved in coordinating other single audits of multi-funded Community Action Agencies which are currently in process. CSA has also arranged with other Federal agencies for cross-service audits. We have such understandings with Legal Services Corporation, Department of Health and Human Services for Head Start and TANF programs, and with the Defense Contract Audit Agency for contract audits.

We appreciate this opportunity to provide the Subcommittee with this summary of CSA actions which we are prepared to amplify with additional oral or written commentary.

Respectfully submitted,



Paul H. Friedman
Inspector General

STATEMENT BY THOMAS F. MURPHY

INSPECTOR GENERAL, UNITED STATES
DEPARTMENT OF AGRICULTURE

before the

SUBCOMMITTEE ON FEDERAL SPENDING PRACTICES
AND OPEN GOVERNMENT

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

June 6, 1980

Mr. Chairman and members of the committee, I am pleased to be here today to discuss problems related to Department of Agriculture programs administered through community action agencies and the Rural Housing Assistance Program.

The General Accounting Office has focused attention on a number of problems in grant management and fiscal responsibility that are found in multi-funded organizations including community action agencies. The Child Care Food Program administered by the Food and Nutrition Service is one USDA program that often involves. The Child Care Food Program is most commonly operated as a supplement to other day care services that are funded through other Federal programs such as Head Start, Title III or IV.

GAO and GIB have documented many serious weaknesses of specific program responsibilities that are unrelated to the fact that the operating organizations may receive grants from several different agencies. I will not go into these

findings today as they are covered in my March, 1980 report to Congress. I would like to point out that the USDA program is frequently a relatively small part of the total Federal grants received by my given private nonprofit sponsor including community action agencies. For that reason the Food and Nutrition Service has some legitimate concerns that adequate audit and investigative resources may not be devoted directly to its program.

Duplicate Funding

In the special GAO reports on fraud and abuse at selected community action agencies, most of the problems that involved the Department of Agriculture dealt with duplicate funding situations where Foodservice costs were paid by another Federal grant as well as the Child Care Food Program. This problem is often closely associated with the cash management and interproject loan problems that GAO also pointed out.

At the time of the GAO review, the Child Care Food Program operated as a reimbursement grant. Funds were carved to children and a claim was then prepared with reimbursement paid at a later date. In practice, the funds available from another grant would frequently be used to finance food service until the reimbursement was received. If the claim was not recorded as a loan to the other grant, the situation would be duplicate funding after the claim reimbursement was paid.

The real problem is that the accounting system necessary to maintain proper control in multi-funded agencies is complex and requires skilled personnel to produce meaningful data. Many Child Care Food Program sponsors lack both the system and the personnel to accomplish this goal. At best the result is a buildup of excessive cash balances or the use of Federal funds intended for food service for some other purpose. At worst, the result is an attractive invitation to fraud.

The duplicate funding problem is exacerbated by the fact that the same food service costs can legitimately be charged to any of several Federal programs. This is the result of legislation and regulations flowing through different Congressional committees and Executive agencies with inadequate efforts at coordination. The sponsors are, in effect, left to themselves to decide where to charge the food service costs with minimal guidance from the program agencies. This is particularly a problem with respect to day care services purchased by a State with Title XX funds. The law and regulations governing Title XX were designed to be very broad and give the States wide discretion in how much of their grant is used for day care and what type of contractual agreements are made with providers. It requires a sponsor to sponsor analysis to determine whether the Child Care Food Program funds inured to the benefit of the child or constituted duplicate funding which merely enhanced the financial status of the sponsor.

Before I detail the actions taken with respect to the sponsors reviewed by GAO, I would like to note some of the actions being taken by the USDA to deal with the duplicate funding issue in general.

The Office of Inspector General is now engaged in a review of the Child Care Food Program in ten States. This involves reviewing the operations of 162 sponsors including 23 community action agencies. While a considerable part of the audit effort will be directed at other program deficiencies surfaced by our past work or by GAO, we will also determine if the sponsor received funds through CSA, CETA, Title XX, or Head Start. If there is obvious duplicate funding, we will report it. In other cases we expect that joint audit work with other Inspectors General will be required.

The Executive Group to Combat Fraud and Waste is now considering a number of projects that would involve cooperative efforts by Inspectors General to deal with audit issues arising from the fact that many federal agencies and departments provide similar or overlapping funding for a variety of activities. One of the proposals involves reviewing the multiple funding of child care feeding operations. As I noted, in addition to the Child Care Food Program there are a variety of federal programs that subsidize day care in one way or another. Since food service is an integral part of day care, this opportunity for multiple funding may open the door to waste and abuse. The lead agency in this project will be USDA. We are now beginning to collect the necessary information on the size and funding structure of the relevant federal programs in order to determine the points of vulnerability at the federal, State and grantee levels.

The Food and Nutrition Service of the Department of Agriculture has held meetings with the Administration for Children, Youth and Families and the Administration for Public Services of the Department of Health and Human Services. The goal of the discussions is to produce memoranda of understanding to cover sponsoring organizations participating in the Child Care Food Program and also receiving funding through Head Start or Title XX. This is necessary to deal with audit findings and to provide guidance to local sponsors so that the problem of duplicate funding can be avoided. As discussed at the staff level, the memoranda will probably provide that since Head Start and Title XX are general programs and the Child Care Food Program is much more specific in intent, its funds will be considered the primary funding source for food service with OHS funds supplementing where necessary to reimburse organizations for the total costs incurred. As a result, dual charges for food service would represent an overclaim of OHS funds and would be recovered by that department. To facilitate avoiding the problem initially, an effort will be made to provide information to Head Start centers participating in the Child Care Food Program to their regional offices. This is already being done for some States.

Finally, the Department of Agriculture has implemented the provision of Public Law 96-487 that provides for advanced funding in the Child Care Food Program. While this should eliminate the problem of having to borrow from another grant to pay for food service costs while awaiting payment from the reimbursement claim, it could pose problems if the State and Federal agencies are not vigilant to ensure that advance claims are properly offset against future claims.

With respect to the specific community action agencies reviewed by GAO, the Department of Agriculture has taken these actions:

Southeastern Tidewater Opportunity Project, Norfolk, Virginia. The GAO findings involved interproject loans that resulted in USDA funds being used to fund deficits incurred by other programs. The GAO recommendations included some very broad actions such as having DHHS act as the sponsor of all Head Start centers participating in the Child Care Food Program. USDA would transfer an appropriate amount of program funds to DHHS and they would pay local sponsors for all Head Start costs including food service.

The Food and Nutrition Service does not agree that such a major adjustment is necessary and feels that advance funding of food service costs and the notification of DHHS regional offices of Head Start centers participating in the Child Care Food Program is an adequate remedy.

Council for Economic Opportunities of Greater Cleveland, Cleveland, Ohio. As noted by GAO, we conducted a review of the Harvest Day Care Center covering 1976. The Center participated in the Child Care Food Program operated by the Council. In our review numerous program irregularities were noted and the Center has not been approved for participation in the Child Care Food Program since that time. Our audit and subsequent investigation have been referred to the Department of Justice for appropriate criminal or civil actions.

Department of Human Services, Chicago, Illinois. In this case GAO pointed out a substantial amount of duplicate funding of food service costs by the Child Care Food Program and the Head Start and Title XX programs. It has been determined that the funds should be recovered as an offset against future DHHS payments.

Community and Economic Development Association of Cook County, Cook County, Illinois. In this review, GAO found duplicate funding of food service costs and an overstated claim for Child Care Food Program reimbursement. As a result, the State Education Agency, has reexamined the claim in light of the GAO findings. The dual charges by the organization for food service costs represent an overclaim of DHHS funds.

Audits of Multi-Funded Organizations

As Inspector General of the U.S. Department of Agriculture, I have been seriously concerned with the problem of improving audit coverage of organizations receiving multiple grants from different federal agencies. Soon after I was named Inspector General, I initiated discussions with the then Inspector General of Health, Education and Welfare, Tom Morris, which led to an agreement to audit jointly administrative costs of State welfare agencies. This was a response to the problem we had found in our prior audits, of grantees shifting questioned costs from one program area, such as food stamps administered by USDA, to another program area, such as Aid to Families with Dependent Children, administered by HEW. To date, we have conducted such joint audits in 14 States. We have also been very willing,

and on occasion have taken the initiative, to participate in joint Inter-Inspector General audit task forces as in the cases of the Social Development Commission in Milwaukee, the Council for Economic Opportunities of Greater Cleveland, Total Community Action of New Orleans, and Northwest Rural Opportunities of Washington State.

It is an undeniable fact that fragmented or sometimes non-existent federal audit coverage of grantees such as community action agencies has been a severe deficiency. I fully support the efforts of OMB, GAO, the Joint Financial Management Improvement Program, the National State Auditors Association and others in developing more effective methods of audit coverage. The most important single policy change has been the promulgation of Attachment P to OMB Circular A-102 in October of last year. Attachment P restated the longstanding OMB requirement (in Circulars A-102 and A-110) for a non-Federal organization-wide financial and compliance audit of each recipient organization. More importantly, it established, for State and local government recipients of Federal assistance, a cognizant federal audit agency structure intended to insure that the audits are performed as often as required and in accordance with prescribed standards and procedures.

I think it is important to distinguish between joint federal audits and the kind of audits contemplated by Circulars A-102 and A-110. There are presently underway a number of initiatives, such as those I described, in which a federal audit task force consisting of auditors from a number of Offices of Inspector General jointly conducts a total grantee audit of all

federal funds. While that is an organization-wide audit, that is not the audit mechanism contemplated by the OMB policy. The OMB policy requires recipients to make their own arrangements for audits to be performed by State or local government auditors or public accounting firms. Federal agencies are to rely on the audit work of the non-federal auditors and not duplicate their work, providing it meets the prescribed standards.

One of the problems encountered in undertaking federal, Inspector General-led, joint audits is the level of federal audit resources available. For example, CSA has several hundred grantees, including community action agencies, but CSA has a present audit staff of only 26. Many of the other OIGs have larger audit staffs, but may still not have sufficient resources to give the multi-funded organizations the attention they deserve. At Agriculture, for example, we have a staff of 440 auditors, but we also have the responsibility for audit coverage of the multi-billion dollar food stamp, school lunch, Farmers Home Administration, Forest Service and many other major programs. Other major grant making agencies such as the Departments of Health and Human Services, Education, Labor and Transportation have a similar range of competing priorities for audit attention.

It is for that and other reasons that I support the policy direction embodied in the OMB Circulars. However, the majority of community action agencies fall within the scope of Circular A-110 which has not yet been amended by OMB to include the cognizant Federal audit agency structure set forth in Attachment P. Incorporation of that structure into A-110 is essential to

insure that the organization-wide financial and compliance audit approach is implemented for those agencies. I understand, however, that OMB has urged CSA to extend the organization-wide audit concept to include the nonprofit community action agencies as well as those encompassed by Circular A-102.

We should all be aware, however, that achieving improved audit coverage consistent with this OMB policy will not be an easy task. The cognizant agency concept contemplates that each recipient organization, such as a community action agency, be assigned to a Federal audit agency which will have audit oversight. The cognizant agency would be responsible for assuring adequate audit coverage and, equally important, adequate followup on any deficiencies disclosed. Since Circular A-110 currently lacks the cognizant audit agency structure, cognizant assignments have not yet been made for community action agencies. However, I understand that OMB has been working with CSA and other affected agencies to develop cognizance assignments for community action agencies. In any event, the cognizance decisions will not be easy ones. As this Committee is well aware, community action agencies receive large numbers of grants, coming from a large number of different federal agencies and sub-agencies, sometimes passing through State agencies, in other cases passing directly to the grantee or via private non-profit agencies.

Another added complexity is the large numbers of sub-grantees. I think the committee is aware that there is a present joint federal audit task force conducting an audit of the Bergen County, New Jersey, community action agency. I am advised that that entity has over 500 sub-grantees. Additional problems that can be anticipated are assuring that the grantee-obtained auditor is truly independent, and in a position to "call them as they see them" in the audit work. A single audit of a multi-funded grantee requires detailed knowledge of legislation, regulations and compliance requirements of a large number of different programs. Compliance with these requirements cannot always be ascertained simply by examining the books and records. Third party verification has to be conducted sometimes involving extensive field work and interviewing. A further problem is the cost of increased audit coverage and the methods for payment. My concern with these issues prompted me to discuss them at greater length in an article which has been submitted for publication to the Journal of The Association of Government Accountants. I have provided a copy of that article to the Committee.

The very serious and complex issues involved in implementing the GAO "single audits" policy have been a subject of deep concern to all the Inspectors General in those agencies with substantial grant programs. As you know, last year the President established the Executive Group to Combat Fraud and Waste. A subcommittee of that group, chaired by Inspector General Soto of the Department of Transportation, has been working on issues connected with implementation of the GAO Circular A-132 audit requirements. In recent weeks there have been very extensive discussions involving the Executive Group and

its Inspector General members, OMB and GAO to define more clearly both the implementation issues and the structure for managing the major task of moving toward improved single audit coverage of federal grant funds.

Rural Housing Assistance Programs

In your request to us, you also expressed concern about reported problems in the rural housing assistance programs. The two major programs in the Department of Agriculture which provide rural housing assistance are the Rural Rental and Rural Housing Programs of the Farmers Home Administration.

RURAL RENTAL HOUSING

The objective of the Rural Rental Housing Loan Program is to provide persons of low or moderate income or senior citizens with economically designed and constructed rental housing and related facilities suited to their living requirements. The loans may be made to individuals, partnerships, corporations, trusts or public organizations. The program has increased at a rapid pace. In 1988 FmHA made 260 loans totaling \$17 million. For 1989 FmHA estimates that \$888 million will be loaned.

Because of the recurrence of problems in this and other programs, the Secretary, in July 1979, appointed an interdepartmental group composed of the Deputy Secretary, Assistant Secretary for Rural Development, Inspector General and the Farm Administrator and charged them with the responsibility

of developing recommendations to improve FmHA's management controls and lessen the susceptibility of certain programs, including the Rural Rental Housing Loan Program, to fraud, waste and abuse.

That group developed over sixty policy, regulatory and legislative recommendations upon which FmHA was to initiate corrective action. The specific problems and corrective action taken by FmHA regarding the Rural Rental Housing Loan Program are as follows:

Appraisals

Loan amounts are generally determined by appraisals. Our audits have disclosed that some appraisals have been made by FmHA personnel to justify a predetermined loan amount rather than to determine the true value of the property. Personnel are not always trained nor do they devote sufficient time to appraising multi-family housing.

The intradepartmental group recommended FmHA consider using certified fee appraisers for all rural rental housing projects and have that cost borne by the applicant. FmHA conducted a feasibility study to evaluate the use of independent appraisers and determined they would use fee appraisers on a pilot basis but would continue with FmHA appraisers and would increase the level of training available to individuals designated as appraisers. Two training courses have been conducted this year.

Market Surveys

The applicants for Rural Rental Housing Program loans are required to demonstrate the need for the projects by completing a market survey. Our audits have disclosed that the surveys frequently overstate the need for the project; they are often poorly prepared and are sometimes falsified. We recommended that FmHA should establish minimum specific data requirements for the surveys and should require certification that the information presented is accurate and correct. FmHA is now in the final stages of issuing revised procedures requiring the certification of market survey data.

Loan Principals

FmHA has no central system controls to identify applicants who are involved with the program in more than one State. As a result our audits have disclosed that borrowers who have demonstrated a lack of ability to carry out successfully the responsibilities of the program are attempting to get projects approved in other States. We recommended that FmHA establish a master index of borrowers at the National Office that would facilitate identification of problem borrowers. FmHA is in the process of adding that capability to their tracking system.

Purchase of Land for Projects

Loan funds can be used to purchase land from an organization in which the applicant has an interest. This practice raises the issue of conflict of interest and in some cases has resulted in borrowers making substantial

profits on the purchase and resale of land. For example, one of our audits disclosed that a partnership using FmHA loan funds, purchased a project site from one of the general partners for \$50,000. The purchase was made eight months after another firm of the same general partner's firm had purchased the site for \$25,000. FmHA is revising its procedures to eliminate the use of loan funds to purchase land where there is an identity of interest by the applicant, except when purchased from a member of a nonprofit applicant.

Cost Certification

FmHA has not required the verification of costs involved in constructing Rural Rental Housing projects. This practice has resulted in loan funds being misused due to the submission of false or erroneous claims by contractors and borrowers. It has also permitted the conversion of savings on one or more parts of the project to profit by not reporting such savings to FmHA.

We recommended that FmHA require the certification of costs of all projects by independent Certified Public Accountants. FmHA is now in the process of issuing new procedures which will require certification of project costs. However, it is only for those projects in which the borrower and the contractor have a common identity of interest.

Tenant Income Certification

The tenants of Rural Rental Housing projects are required to certify their incomes so that FmHA can determine the amount of interest credit (subsidy) to be allocated to the borrower. We have found instances in which these certifications are inaccurate or falsely prepared. Understating the tenant's income results in the borrower being credited with more interest credit than they are entitled to receive.

We recommended that FmHA personnel be required to review and verify tenant income certification submitted by the borrower. FmHA is revising its procedures to require district office personnel to verify income certifications by conducting a random sample. If the random sample discloses discrepancies, the District Director will be required to investigate further.

Excess Rental Income

We conducted a joint audit of a public housing authority with auditors of the Office of Inspector General, Department of Housing and Urban Development. The authority administers both the FmHA Rural Rental Housing projects and the HUD rental assistance (section 8) program. The audit disclosed that the authority received excess rental income of over \$37,000. Although HUD regulations prohibit it from making rental assistance payments for tenants occupying units owned by a public housing authority, there were 28 such tenants in the project and the authority was billing HUD for the rates established for the rental assistance

program rather than the rate established by FmHA. For example, the FmHA monthly rental rate for one of the three bedroom units in the project was \$113. The HUD rental assistance monthly rate for a three bedroom unit was \$229. The tenant was obligated to pay \$15 per month and the authority was billing HUD for \$214 per month rather than \$113.

As a note of explanation, FmHA rental rates represent the amount necessary to amortize the loan and meet operating and maintenance expenses, whereas the rates established by HUD represent the fair market rental rates for comparable privately financed multi-family housing units in the general locale.

This audit finding led to a joint review by the Inspectors General of HUD and USDA of the Rural Rental Housing and HUD rental assistance programs in three other States. We found the same practice on a smaller scale in one State and no similar problems in the other two. This problem was brought to the attention of FmHA and HUD by our audit staff. As a result both have revised their procedures to require closer coordination of their program staffs, and both further agreed that HUD reimbursements would be based on the monthly rental rates established by FmHA when qualified tenants were occupying Rural Rental Housing units. This should eliminate the possible reoccurrence of the problem.

Current Audit Effort

We are currently conducting a nationwide audit in order to determine the extent of the problems discussed above. The audit will examine a statistical sample of approximately 90 loans.

RURAL HOUSING

The other major program administered by the Department to assist rural residents obtain decent housing is the Rural Housing Loan Program. In this program loans are made to individuals in rural areas, in towns of not more than 10,000 population, or in areas between 10,000 and 20,000 population that are not within Standard Metropolitan Statistical Areas. To be eligible for the loans, the applicant must have low to moderate incomes (adjusted annual income of \$15,600 or less), be unable to secure financing from normal commercial sources and be without a decent, safe and sanitary home of their own. Interest credits (subsidies) may be granted to lower income families which reduces the interest rate on the loan to as low as one percent. The amount of the interest is dependent on the income and family size of the applicant.

FmHA estimates it will issue loans totaling \$2.5 billion during FY 1981 in the Rural Housing Loan Program.

Our audits have disclosed several problems in the administration of the program including:

- o FmHA has approved loans for houses located in subdivisions without adequate community facilities such as water and sewer services or fire protection. Loans have also been approved in areas having poor drainage. This has occurred even though FmHA instructions explicitly define the characteristics that must exist before a subdivision is approved for loans.
- o Construction inspections have not always been made, or when made they have not always been adequate.
- o FmHA has also experienced problems in the management of properties acquired through foreclosure or through voluntary conveyance. During a recent audit we noted the dollar loss on the sale of acquired properties was \$15 million during 1978. This audit disclosed that between September 1977 and February 1979 FmHA sold 41 inventory houses in one county in Virginia to private investors at prices ranging from \$3,850 to \$6,000. Several of these homes were then brought back into the program using Rural Housing loans for prices ranging from \$23,400 to \$25,350. These transactions resulted apparently in substantial profits for the private investors.

Our reviews in Florida, Delaware, Maryland and Pennsylvania also showed that inventory properties were often sold at low prices to investors rather than FmHA spending a limited amount to repair the houses and reselling them at or near the market value thereby limiting or eliminating any possibility of dollar loss.

In addition FmHA cannot identify those subdivisions which are experiencing delinquency problems or those in which corrective action needs to be taken. The lack of this capability prevents FmHA from initiating steps to correct the situation before it becomes a major problem.

- o FmHA has not been adjusting interest credit (subsidy) agreements when a borrower's income increases during the two year term of the agreement. FmHA reviews the agreements every two years to determine if the borrower still qualifies for the level of interest credit agreed to when the loan was closed. An audit conducted by our office three years ago projected excess interest credits of \$20 million had been made over a two year period because adjustments had not been made when borrower's income had increased. Nor had FmHA collected the adjustments retroactively.

o FmHA has failed to graduate borrowers to commercial sources of credit when warranted by the improved financial status of the borrower. The benefit to the government of graduating these borrowers is the savings in interest costs. An additional benefit derived from graduation is the ability to redirect loan funds to other qualified applicants.

Current Audit Effort

As mentioned above a previous audit disclosed problems regarding the failure to adjust interest credit agreements, as required, when changes in borrowers' income warranted such a change. We are currently conducting an audit to determine the current extent of that problem. The audit is examining a statistical sample of borrowers to determine if their incomes have changed during the period of the interest credit agreement; ascertain whether the agreements were adjusted when warranted and, if not, determine the amount of excess interest credit being granted to the borrowers.

This concludes my prepared remarks I will be pleased to answer any question the Committee may have.

PREPARED STATEMENT OF RICHARD B. LOWE III
ACTING INSPECTOR GENERAL, DEPARTMENT OF HEALTH AND HUMAN SERVICES

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

MY NAME IS RICHARD B. LOWE III, ACTING INSPECTOR GENERAL AT THE DEPARTMENT OF HEALTH AND HUMAN SERVICES, AND I AM ACCOMPANIED BY MANUEL CARBALLO, DEPUTY ASSISTANT SECRETARY FOR HUMAN DEVELOPMENT SERVICES AND PHILIP KROPATKIN, ACTING ASSISTANT INSPECTOR GENERAL FOR AUDIT.

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY, MR. CHAIRMAN, AND BRING YOU AND THE SUBCOMMITTEE UP TO DATE ON THE ACTION TAKEN BY THE DEPARTMENT TO REMEDY THE PROBLEMS AT COMMUNITY ACTION AGENCIES YOU FIRST CALLED TO OUR ATTENTION IN MARCH 1979. I ALSO WOULD LIKE TO SUMMARIZE FOR YOU THE PROGRESS OF THE COMPREHENSIVE AUDIT AT THE COUNCIL FOR ECONOMIC OPPORTUNITY IN GREATER CLEVELAND, OHIO, AT THE CHAIRMAN'S REQUEST THE SPENDING PRACTICES OF COMMUNITY ACTION AGENCIES HAVE BEEN UNDER REVIEW BY THE GENERAL ACCOUNTING OFFICE (GAO). IN MARCH 1979, GAO PRESENTED PRELIMINARY FINDINGS ON THE GREATER CLEVELAND COUNCIL AND SEVERAL OTHER COMMUNITY ACTION

AGENCIES, AND IN OCTOBER 1979 SAO AUDITORS DEVELOPED IN GREATER DETAIL INSTANCES OF ABUSE AND MISUSE OF FEDERAL FUNDS BY THE ORGANIZATIONS REVIEWED. THE MAJOR PROBLEMS REPORTED INCLUDED: EXCESSIVE AMOUNTS OF FEDERAL CASH IN THE HANDS OF GRANTEEES LEADING TO EMBEZZLEMENT AND DIVERSION OF FUNDS IN SOME CASES; DUAL REIMBURSEMENT TO GRANTEEES FOR THE SAME EXPENDITURES BY DIFFERENT FEDERAL AGENCIES SUCH AS AGRICULTURE AND HHS; LOST, STOLEN OR MISAPPROPRIATED FIXED ASSETS RANGING FROM LAWNMOWERS TO AUTOMOBILES; LARGE LOANS BETWEEN PROJECTS FUNDED BY HHS, CSA, AGRICULTURE AND THE LABOR DEPARTMENT; AND A VARIETY OF OTHER ABUSES INVOLVING UNAUTHORIZED AND EXCESSIVE PROJECT EXPENDITURES. PIECEMEAL, UNCOORDINATED GRANT-BY-GRANT AUDITS BY THE VARIOUS FEDERAL AGENCIES WERE IDENTIFIED AS HAVING CONTRIBUTED TO THE CONTINUATION OF THE PROBLEMS.

FOLLOWING THE HEARINGS OF YOUR SUBCOMMITTEE IN MARCH, WE BEGAN TAKING STEPS TO CORRECT THE PROBLEMS IDENTIFIED, AND SOME OF THOSE ACTIONS ARE STILL UNDERWAY.

- PROGRAM MANAGERS AND THE DEPARTMENT'S ACCOUNTING STAFF ARE PUTTING IN PLACE STRONGER PROCEDURES TO ACCOUNT

FOR AND MANAGE HHS GRANT AWARDS. REGULATIONS DESIGNED TO REDUCE THE GAP BETWEEN BUDGETED AND ACTUAL HEAD START ENROLLMENT WERE PUBLISHED ON NOVEMBER 2, 1979.

• THE OIG INTENSIFIED AUDIT AND INVESTIGATIVE ATTENTION ON SEVERAL COMMUNITY ACTION AGENCIES:

- A SPECIAL COMPREHENSIVE AUDIT OF THE CLEVELAND COUNCIL WAS ARRANGED WITH CSA, AGRICULTURE, LABOR, AND OTHER FEDERAL AGENCIES.
- ACTION WAS TAKEN TO EXTEND THE SINGLE AUDIT CONCEPT AND UPGRADE THE QUALITY OF NON-FEDERAL AUDITS.
- INVESTIGATIONS RELATED TO COMMUNITY ACTION AGENCIES THAT WERE INITIATED PRIOR TO THE OCTOBER HEARINGS HAVE RESULTED IN FIVE CONVICTIONS THUS FAR. SINCE THE OCTOBER HEARINGS, WE HAVE OPENED AN ADDITIONAL 11 INVESTIGATIONS WHERE ILLEGALITY WAS INDICATED IN THE OPERATIONS OF COMMUNITY ACTION AGENCIES. WE NOW HAVE A TOTAL OF 29 OPEN CRIMINAL CASES INVOLVING COMMUNITY ACTION AGENCIES.

PROGRAM AND FINANCIAL MANAGEMENT

IN THE PAST SIX MONTHS, THE ASSISTANT SECRETARY FOR HUMAN DEVELOPMENT SERVICES (HDS) AND THE ASSISTANT SECRETARY FOR MANAGEMENT AND BUDGET

(ASMB) HAVE TAKEN ACTION ON THEIR COMMITMENT TO STRENGTHEN PROGRAM AND FINANCIAL MANAGEMENT AT COMMUNITY ACTION AGENCIES RECEIVING HHS FUNDS. BASED ON THE PROBLEMS DISCLOSED BY GAO, INFORMATION DEVELOPED BY MY STAFF AND ANALYSES CONDUCTED BY THEIR OWN STAFFS, TOP OFFICIALS HAVE PUT IN PLACE IMPROVED PROCEDURES INVOLVING FINANCIAL REPORTING AND MONITORING, HEAD START ENROLLMENT, AND GRANTEE MANAGEMENT.

THE ACCUMULATION OF VERY LARGE AMOUNTS OF FEDERAL FUNDS IN THE HANDS OF GRANTEES REPRESENTS PERHAPS THE MOST SERIOUS PROBLEM IN PROGRAM AND FINANCIAL MANAGEMENT. WEAKNESSES IN REPORTING AND MONITORING GRANTEE'S FINANCIAL OPERATIONS CONTRIBUTED TO THE BUILD-UP OF LARGE CARRY-OVER BALANCES--UNLIQUIDATED OBLIGATIONS ON THE FEDERAL BOOKS, PARTICULARLY IN THE CHICAGO REGION. TO DEAL WITH THESE WEAKNESSES, THE DEPARTMENT HAS TAKEN SEVERAL STEPS:

- HEAD START PROGRAM MANAGERS IN HHS ANALYZED FUNDING RECORDS, IDENTIFIED CARRY-OVER BALANCES, AND RECOMMENDED ADJUSTMENTS OF EXCESS FUNDING.
- ACCOUNTING STAFF UNDER ASMB HAVE REVIEWED THE RECORDS

ON ALL OPEN HEAD START GRANTS AND ARE WORKING WITH HDS TO VERIFY THE FUNDING STATUS OF EACH GRANT.

- ACCOUNTING STAFF ARE BEGINNING AN ANALYSIS OF THE PAYMENT METHODS IN USE FOR HEAD START. GRANTEES OBTAIN FEDERAL CASH EITHER BY RECEIVING MONTHLY TREASURY CHECKS OR BY DRAWING MORE FREQUENTLY UNDER A LETTER OF CREDIT. THIS ANALYSIS SHOULD RESULT IN INCREASED USE OF THE MORE EFFICIENT LETTER-OF-CREDIT METHOD AND DECREASED USE OF THE CHECK PAYMENT METHOD.
- TO ENCOURAGE MORE FREQUENT AND TIMELY CASH WITHDRAWALS, LARGER NUMBERS OF WITHDRAWAL FORMS ARE BEING SENT TO EACH GRANTEE FUNDED BY LETTER OF CREDIT. IN THE PAST, THE LIMITED NUMBER OF WITHDRAWAL FORMS PROVIDED CAUSED MANY LETTER-OF-CREDIT HOLDERS TO DRAW ONLY MONTHLY AND HOLD EXCESS CASH RATHER THAN DRAW WEEKLY OR BIWEEKLY BASED ON ACTUAL CASH NEEDS.
- THE BASIS OF RECORDING EXPENDITURES IN THE DEPARTMENT'S ACCOUNTING RECORDS HAS BEEN CHANGED. EXPENDITURES REPORTED IN CURRENT PERIODS WILL NOW BE CHARGED TO THE AWARD FOR THE CURRENT PERIOD RATHER THAN TO THE OLDEST OPEN AWARD. THIS BASIS SHOULD MORE EFFECTIVELY IDENTIFY WHERE SIGNIFICANT UNLIQUIDATED OBLIGATIONS EXIST AND PERMIT ANALYSIS TO DETERMINE THE ACTION NECESSARY.
- HDS HAS ESTABLISHED MORE SPECIFIC POLICIES ON DEALING

WITH EXCESSIVE CARRY-OVER BALANCES, AND IS RECAPTURING \$8 MILLION IN OUTSTANDING CARRY-OVER BALANCES FROM HEAD START GRANTEES ACROSS THE COUNTRY. THESE MONIES WILL BE RETURNED TO THE TREASURY IN FY 1980. HDS HAS ALSO ESTABLISHED A SPECIFIC POLICY DIRECTED TOWARD PREVENTING THE ACCUMULATION OF LARGE CARRY-OVER BALANCES BY HEAD START GRANTEES. THIS IS INCLUDED IN THE HDS STAFF MANUAL FOR GRANTS OFFICES AND WILL BE INCORPORATED INTO THE GRANTS ADMINISTRATION MANUAL FOR GRANTEES THIS SUMMER.

THE POLICY PROVIDES THAT GRANTEES WILL NOT BE PERMITTED TO HAVE SUBSTANTIAL UNOBLIGATED BALANCES AVAILABLE FROM PAST FUNDING. THEREFORE, EXCEPT IN UNUSUAL AND JUSTIFIED CIRCUMSTANCES, ACTION WILL BE TAKEN TO REDUCE THE OBLIGATION AUTHORITY AVAILABLE WHEN THE REPORTED UNOBLIGATED BALANCE EXCEEDS 20 PERCENT OF THE AMOUNT AUTHORIZED (10 PERCENT FOR AUTHORIZATIONS IN EXCESS OF \$1 MILLION). IN CASES WHERE THE BALANCE IS LESS THAN 20 PERCENT, HDS MAY EXERCISE THE OPTION TO MAKE AN OFF-SET (DEDUCTION) FROM A CONTINUATION AWARD OR APPROVE THE USE OF THE BALANCE BY THE GRANTEE AS A ONE-TIME EXPENDITURE FOR SPECIAL NEEDS.

- HDS HAS INITIATED A MAJOR EFFORT TO REVIEW THE FISCAL-ADMINISTRATIVE SYSTEM OF ALL HEAD START GRANTEES AND THEIR DELEGATE AGENCIES OVER A THREE-YEAR PERIOD BEGINNING IN FY 1980.

THE PURPOSE OF THIS ON-SITE REVIEW IS TO DETERMINE THE EXTENT TO WHICH HEAD START GRANTEES AND THE DELEGATE AGENCIES ARE OPERATING PROGRAMS CONSISTENT WITH SOUND FINANCIAL MANAGEMENT PRACTICES AND PRESCRIBED DEPARTMENTAL POLICIES AND PROCEDURES. FOLLOW-UP TRAINING AND TECHNICAL ASSISTANCE WILL BE PROVIDED TO GRANTEES IN ORDER TO CORRECT DEFICIENCIES NOTED IN THE REVIEWS.

SINCE MARCH 1980, 65 HEAD START GRANTEES HAVE RECEIVED A FISCAL/ADMINISTRATIVE REVIEW. IN FY 1981, AND IN SUBSEQUENT YEARS, THE HDS FINANCIAL MANAGEMENT INITIATIVE CALLS FOR A COMPLETE ON-SITE REVIEW OF THE APPROXIMATELY 1,139 HEAD START GRANTEES. THIS WOULD ENTAIL AN ON-SITE REVIEW OF ONE-THIRD OF THE GRANTEES ANNUALLY.

- ENROLLMENT SHORTFALLS ALSO MAY HAVE CONTRIBUTED SIGNIFICANTLY TO THE GROWTH OF EXCESSIVE BALANCES. HDS HAS NOW PUBLISHED REGULATIONS ON RECRUITMENT, ENROLLMENT, MAINTENANCE OF ENROLLMENT, AND ATTENDANCE. THESE REGULATIONS PROVIDE FOR HDS MONITORING OF ENROLLMENT LEVELS AND ACTION TO REDUCE FUNDING LEVELS WHERE A GRANTEE PROVES UNABLE TO MAINTAIN FUNDED ENROLLMENT LEVELS.

NON-FEDERAL AUDIT

THE OFFICE OF THE INSPECTOR GENERAL (OIG) HAS TAKEN STEPS TO STRENGTHEN

NON-FEDERAL AUDITING OF OUR FUNDS AT COMMUNITY ACTION AGENCIES. AS WE POINTED OUT IN OCTOBER, IMPROVEMENTS CAN BE MADE IN MOVING FROM A GRANT-BY-GRANT AUDIT TO AN ORGANIZATION-WIDE AUDIT, AND BY CONTINUING EFFORTS TO UPGRADE THE QUALITY OF NON-FEDERAL AUDITS.

HEAD START REGULATIONS REQUIRE EACH ORGANIZATION RECEIVING PROGRAM FUNDS TO HAVE AN INDEPENDENT AUDIT COVERING THE PRECEDING BUDGET PERIOD--USUALLY A YEAR. THESE AUDITS, ARRANGED BY THE GRANTEE USUALLY WITH CERTIFIED PUBLIC ACCOUNTANTS, MUST BE PERFORMED IN ACCORDANCE WITH STANDARDS FOR GOVERNMENTAL AUDITING AND GUIDELINES PUBLISHED BY THE OIG AUDIT AGENCY. THE DEPARTMENT FOLLOWS THE PROVISIONS OF FEDERAL POLICY IN RELYING ON THE WORK OF NON-FEDERAL AUDITORS. THE OIG AUDIT AGENCY OPERATES AN ONGOING REGIONAL QUALITY CONTROL PROGRAM TO REVIEW AND EVALUATE AUDIT REPORTS RECEIVED FROM NON-FEDERAL AUDITORS. IN FISCAL YEAR 1979, WE REVIEWED, EVALUATED, AND ISSUED 5,000 REPORTS--ABOUT 1,200 DEALING WITH HEAD START GRANTS.

MY OFFICE IS CONTINUING TO ACT ON THE TWO MAJOR WEAKNESSES IN THE

CURRENT APPROACH TO AUDITING HEAD START FUNDS AT COMMUNITY ACTION AGENCIES--PIECEMEAL, GRANT-BY-GRANT AUDITS AND LOW QUALITY NON-FEDERAL AUDIT WORK. WE BELIEVE WORTHWHILE PROGRESS HAS BEEN MADE ON EACH WEAKNESS.

A COOPERATIVELY ARRANGED, COMPREHENSIVE AUDIT OF FEDERAL FUNDS FOR THE MOST RECENT PROGRAM YEAR IS UNDERWAY AT THE CLEVELAND COUNCIL. OUR ACTIVITY IN CLEVELAND DESERVES SPECIAL ATTENTION SINCE IT MAY PROVE TO BE A MODEL FOR OTHER AUDITS. WHEN THE DEFICIENCIES AT THE CLEVELAND COUNCIL CAME TO OUR ATTENTION, TOM MORRIS, THEN HEW INSPECTOR GENERAL, INITIATED A COMPREHENSIVE AUDIT OF ALL FEDERAL FUNDS AT THE AGENCY IN COOPERATION WITH OTHER FEDERAL DEPARTMENTS. AT THE CLEVELAND COUNCIL THE AUDIT FIRM OF DELOITTE, HASKINS AND SELLS IS NOW WRAPPING UP WORK ON THE COMPREHENSIVE AUDIT. THE FINAL REPORT SHOULD BE PREPARED BY THE END OF SEPTEMBER, AND A COPY WILL BE PROVIDED TO THE SUBCOMMITTEE AS SOON AS IT IS AVAILABLE. PRELIMINARY AUDIT RESULTS HAVE LARGELY CONFIRMED THE DEFICIENCIES REPORTED AND IDENTIFIED SEVERAL ADDITIONAL AREAS OF POSSIBLE ABUSE WHICH THE FEDERAL AGENCIES INVOLVED ARE PURSUING.

THE COMPREHENSIVE AUDIT APPROACH AT THE CLEVELAND COUNCIL ESSENTIALLY FOLLOWS THE SINGLE AUDIT CONCEPT; HOWEVER, THE PARTIES INVOLVED HAD TO WORK OUT THE ARRANGEMENTS ON AN AD HOC BASIS BECAUSE OMB HAS NOT DESIGNATED ONE FEDERAL DEPARTMENT AS RESPONSIBLE FOR ALL FEDERAL AUDIT WORK AT THIS TYPE OF GRANTEE. THE ABSENCE OF AN AUDIT COGNIZANCE DESIGNATION HAMPERS EFFORTS TO EFFECTIVELY IMPLEMENT THE SINGLE AUDIT CONCEPT.

MY OFFICE HAS ACTED TO PUT THE SINGLE AUDIT CONCEPT INTO OPERATION, INSOFAR AS POSSIBLE WITHIN OUR EXISTING AUTHORITY. TO EXTEND THE SINGLE AUDIT CONCEPT, THE OIG AUDIT AGENCY, HDS AND CSA ARE WORKING TOGETHER ON ARRANGING COMBINED AUDITS OF HEAD START AND CSA FUNDS AT COMMUNITY ACTION AGENCIES. ALTHOUGH SOME TECHNICAL ISSUES REMAIN TO BE SOLVED, WE HAVE AGREED TO INSTRUCT GRANTEES TO HAVE COMBINED AUDITS PERFORMED. COMBINED AUDITS OF HEAD START AND CSA FUNDS HAVE ALREADY BEEN PERFORMED BY NON-FEDERAL AUDITORS AT SEVERAL COMMUNITY ACTION AGENCIES. AT THIS TIME, OIG AUDITORS ARE USING COMPUTER MATCH TECHNIQUES TO DEVELOP A LISTING OF GRANTEES WHICH RECEIVE FUNDS FROM BOTH SOURCES AND ARE PREPARING GUIDELINES

FOR NON-FEDERAL AUDITORS ON COMBINING THE AUDITS. THE COMPLETE SET OF INSTRUCTIONS SHOULD BE ISSUED THIS SUMMER. THESE COMBINED AUDITS WILL COVER A SUBSTANTIAL PORTION OF FEDERAL FUNDS AT THE GRANTEE, BUT NOT ALL FUNDS. WHILE OTHER FEDERAL AGENCIES MAY JOIN, ASSIGNMENT OF AUDIT COGNIZANCE WOULD BE NECESSARY TO ASSURE FULL COVERAGE. WE INTEND TO MAKE THE COMBINED AUDIT OUR STANDARD APPROACH FOR EXAMINING COMMUNITY ACTION AGENCIES WHICH RECEIVE HEAD START FUNDS--AT LEAST UNTIL THE TRUE SINGLE AUDIT IS IN OPERATION FOR COMMUNITY ACTION AGENCIES.

THE OIG AUDIT AGENCY GIVES CONSTANT ATTENTION TO MAINTAINING AND IMPROVING THE QUALITY OF NON-FEDERAL AUDIT WORK DONE FOR THE DEPARTMENT. SINCE FISCAL YEAR 1975, WE HAVE INCREASED THE PERCENTAGE OF RESOURCES ASSIGNED TO REVIEWING AND EVALUATING NON-FEDERAL AUDIT REPORTS OVER 400 PERCENT; THE CURRENT WORK PLAN PROVIDES FOR AN INCREASE OF 20 PERCENT. SUCH INCREASES AND THE OTHER IMPROVEMENTS INITIATED HAVE ENABLED US TO DO A BETTER, MORE SYSTEMATIC EXAMINATION OF THE AUDITS. HOWEVER, THERE IS STILL ROOM FOR IMPROVEMENT.

IN PREVIOUS TESTIMONY OUR RECENT ACTIONS TO MAKE ONGOING, FUNDAMENTAL IMPROVEMENTS IN THIS AREA OF ACTIVITY WERE DESCRIBED IN SOME DETAIL. TO SUMMARIZE:

- WE HAVE REDESIGNED PARTS OF OUR SYSTEM TO ADDRESS WEAKNESSES DISCLOSED BY GAO REVIEW.
- REVISED INSTRUCTIONS FOR EXAMINING REPORTS PREPARED BY NON-FEDERAL AUDITORS WERE ISSUED.
- WE INCREASED THE PERCENTAGE OF REPORTS RANDOMLY SELECTED FOR WORKING PAPER REVIEW.
- AS A RESULT OF THE CLEVELAND COUNCIL SITUATION, WE NOW REQUIRE EACH REPORT TO BE SCREENED WITHIN FIVE DAYS OF RECEIPT FOR MATTERS NEEDING PROMPT ACTION, SUCH AS APPARENT PROGRAM ABUSE.
- COURSES IN AUDITING HEAD START GRANTS WERE DEVELOPED AND PRESENTED.
- DETAILED MANAGEMENT INFORMATION ON REGIONAL PERFORMANCE IS NOW MONITORED AT THE HEADQUARTERS LEVEL.
- THE AUDIT AGENCY HAS BEGUN TO IDENTIFY THE CHANGES NEEDED TO EFFICIENTLY PROCESS ORGANIZATION-WIDE, SINGLE AUDITS UNDER OUR MANAGEMENT SYSTEMS.

SINCE OUR APPEARANCE IN OCTOBER, WE HAVE TAKEN FURTHER STEPS TO IMPROVE THE QUALITY OF NON-FEDERAL AUDITS. IN DECEMBER I JOINED WITH SEVERAL OTHER INSPECTORS GENERAL AS PARTICIPANTS IN A NATION-WIDE INQUIRY CONDUCTED BY THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (AICPA) INTO THE PROBLEM OF LOW QUALITY CPA AUDITS. TO BEGIN OUR PARTICIPATION, THE AUDIT AGENCY SUBMITTED 21 RECENT REPORTS WHICH OUR REVIEW AND EVALUATION SYSTEM HAD IDENTIFIED AS POTENTIALLY SUBSTANDARD TO THE AICPA FOR ITS ANALYSIS.

ONE WAY OF RAPIDLY AND DIRECTLY ADDRESSING THE ISSUES OF AUDIT QUALITY AND GRANTEE MANAGEMENT WEAKNESSES DESCRIBED BY GAO IS THROUGH OUR GUIDE FOR EXAMINING HEAD START GRANTS. THE GUIDE, FIRST PUBLISHED IN 1973 THEN SUBSTANTIALLY REVISED IN 1977, IS NOW BEING UPDATED FOR CHANGES IN THE AUTHORIZING LEGISLATION AND PROGRAM REGULATIONS, AND FOR LESSONS LEARNED SINCE PUBLICATION OF THE PREVIOUS GUIDE. OUR AUDITORS ARE EXPLORING WITH HDS AND THE DEPARTMENT'S FINANCE SPECIALISTS WAYS TO MAKE THE AUDIT REPORT MORE EFFECTIVE IN DEALING WITH CASH MANAGEMENT AND FUND CONTROL. THE AUDIT PROCEDURES FOR EXAMINING FOOD COST REIMBURSEMENTS

WILL BE STRENGTHENED TO DEAL WITH DUPLICATE PAYMENTS. THE PROPERTY MANAGEMENT SECTION WILL ALSO BE FURTHER STRENGTHENED. THE NEW GUIDE WILL CALL FOR MORE ANALYSIS OF ELIGIBILITY AND ENROLLMENT DATA.

THE TRAINING COURSES FOR NON-FEDERAL AUDITORS JOINTLY SPONSORED BY THE DEPARTMENT AND THE AICPA WILL CONTINUE IN 1980. LAST YEAR SEVERAL HUNDRED AUDITORS ATTENDED SUCH COURSES. THIS YEAR THE HEAD START COURSE IS SCHEDULED FOR TWO NEW REGIONS--DALLAS AND SAN FRANCISCO--AND TWO SESSIONS ARE SET FOR THE CHICAGO REGION. COURSE PRESENTATIONS HAVE BEEN REVISED TO EMPHASIZE ANTICIPATED PROBLEM AREAS.

IN CONCLUSION, I WOULD LIKE TO STATE THAT THE DEPARTMENT IS ACUTELY AWARE OF THE PROBLEMS AT COMMUNITY ACTION AGENCIES, AND THAT WE ARE TACKLING THE ISSUES RAISED IN EARNEST. THE SUBCOMMITTEE'S ATTENTION HAS HELPED CREATE A HEALTHY SENSE OF URGENCY. WHILE IT IS TOO EARLY TO ASSESS THE REAL IMPACT OF THE ACTIONS UNDERWAY, THERE ARE INDICATIONS THAT THE SITUATION WILL IMPROVE. HDS IS NOW RECAPTURING \$8 MILLION IN OUTSTANDING CARRYOVER BALANCES FROM HEAD START GRANTEES ACROSS THE COUNTRY. OTHER ACTIONS UNDERWAY AND THE FOLLOW-UP

STEPS, WHICH ARE NECESSARY, SHOULD RESULT IN SIGNIFICANTLY BETTER

FEDERAL OVERSIGHT IN THE LONG RUN, I WILL CONTINUE TO MONITOR

CLOSELY THE DEPARTMENT'S PROGRESS IN THIS AREA.

AGAIN, I WOULD LIKE TO TAKE THIS OPPORTUNITY TO THANK YOU FOR LET-

TING ME APPEAR BEFORE YOU TODAY. I SHALL BE GLAD TO ANSWER QUESTIONS.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20201

OFFICE OF THE INSPECTOR GENERAL

The Honorable Lawton Chiles
Chairman, Subcommittee on Federal
Spending Practices and Open Government
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

I am pleased to respond to the two questions raised in your recent letter concerning the Department's involvement with community action agencies. Your hearings in October 1979 and earlier this month have focused top management attention on correcting the administrative problems relating to such organizations. The actions which the Department has initiated give promise of significant improvement.

A. Question: The situation in Cleveland got the Committee started on the problem with multi-funded agencies. Is there any way that the Cleveland case would have been avoided in your estimation?

Answer: From the Federal level, the risks of experiencing excess cash, bad grantee management, and gaps in audit coverage can be minimized by strengthening our oversight of the organizations. As I outlined in my testimony at the June hearings, the Department has actions underway to improve monitoring. Our program and financial managers have intensified their analysis of grantee operations and have made fundamental changes in monitoring, reporting, and accounting procedures to better control our funds. My office also supports the single audit concept as an important mechanism to provide comprehensive audit coverage at community action agencies.

B. Question: Last October your Audit Chief testified before this Committee that the Department of Human Services was taking steps to recover about 3 million in interest generated in the Chicago Region as well as the excess funds that are in the millions which are still in bank accounts in community action agencies. Do you now know how much in excess funds are in Health and Human Services accounts among community agencies?

Answer: An exact figure for all Department funds is not available primarily because community action agencies receive funds both directly from the Department and indirectly through programs administered by the States, as well as other nonprofit organizations. Last Fall, the Office of Human Development Services (HDS) conducted a special study of the Head Start program which indicated that \$36 million in unobligated program funds was in grantee accounts throughout the country. Sixteen million dollars of that total was in grantee accounts in the Chicago Region. Head Start annually awards \$700 million in grants to public and private nonprofit organizations, including community action agencies. HDS has advised us that while national totals of reprogrammed funds have not been computed, \$6 million has been reprogrammed in the Chicago Region.

At Cleveland, \$34,000 was recovered last Fall from idle accounts and further recoveries may be made based on the single audit in process. As HDS officials and Department accounting staff work together to adjust grantee awards for excess cash, recovery will be made of interest earned on excess funds. In the Chicago Region, program officials are awaiting audit verification of interest earnings.

Please contact me if you would like further information. I shall continue to monitor the Department's progress on solving the problems involving our funds at community action agencies.

Sincerely yours,

Richard B. Lowe III
Acting Inspector General

STATEMENT OF RONALD GOLDSTOCK
 ACTING INSPECTOR GENERAL
 BEFORE THE
 SUBCOMMITTEE ON FEDERAL SPENDING
 PRACTICES AND OPEN GOVERNMENT
 OF THE
 COMMITTEE ON GOVERNMENT AFFAIRS
 UNITED STATES SENATE

June 5, 1980

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you today to discuss the single audit concept, the current audit of the District of Columbia Comprehensive Employment and Training Act (CETA) program, and the General Accounting Office's (GAO) findings on community action organizations.

The single audit concept contemplates one comprehensive audit of all Federal funds received by a grantee. The advantages of this concept are many. It avoids duplication of audit effort and is therefore cost efficient. A better picture of the grantee operation is obtained because all transactions are subject to review. Therefore, there is less chance of transactions being missed--a distinct danger under separate fragmented audits.

There are several different arrangements possible for implementing the single audit concept. For example, one Federal agency might audit all Federal funds received by the grantee. Or, auditors from several Federal agencies might participate in a joint auditing effort. Another method is for the cognizant agency to arrange for an audit to be conducted by independent Certified Public Accountants or by State or local auditors. The grantee may also, as is prescribed by OMB Circular A-102, Attachment P, arrange for the audit to be done in accordance with Federal guidelines.

The Department of Labor (DOL) is committed to the single audit concept. We feel that this is the only effective way to audit those recipients receiving funding from multiple organizations. We have found that separate fragmented audits do nothing more than perpetuate the type of problems delineated by GAO in their October 19, 1979 testimony before this subcommittee. We have recognized the benefits of the single audit concept and are moving ahead in that direction.

We have 10 audits of this type in process now. As examples, in Bergen County, New Jersey, we began an audit on May 12, 1980 which involves funds from the Department

of Health and Human Services (HHS) as well as funds from Community Services Administration (CSA). In New Orleans, we also started a joint audit of the Total Community Action Agency in April 1980. Other participating Federal agencies include Agriculture, HHS and CSA. In addition, CSA and DOL are conducting a joint audit of the United Farmworkers of America.

In Los Angeles, the Department of Labor is auditing all Federal funds received by The East Los Angeles Community Union. It will encompass audit of HHS funds as well as funding by the Department of Housing and Urban Development (HUD), CSA and the Department of Agriculture.

In Long Beach, California, we are conducting a pilot project for the Office of Management and Budget (OMB). Under the provisions of OMB Circular A-102, Attachment P, the city auditor has negotiated to audit all Federal funds received by the city. The Department of Labor has been designated cognizant agency for this purpose, which means that it will provide quality control and general oversight of the audit work.

We realize that the efforts we have made are just a beginning. We are negotiating with other Federal agencies for additional audits like these. Meanwhile,

one of the things that would help us most in this area would be the swift completion of permanent audit cognizance assignments by OMB. This would enable us to further define our audit responsibilities and move ahead to fulfill them. We have been working with OMB on the determination of these assignments.

Now, I would like to address the audit situation relating to the CETA funds awarded to the District of Columbia. An audit currently is being conducted of CETA funds awarded to the District of Columbia prime sponsor. The audit does not include audits of the funds which were awarded to subrecipients by the District. When the audit was originally planned in June 1979, we anticipated making it a unified audit in which the subrecipients would be audited by the same firm conducting the audit of the District of Columbia prime sponsor for the OIG. The District was informed of this in a meeting on June 8, 1979.

From June 1979 through October 1979, when our audit of the prime sponsor began, several discussions were held with D.C. officials regarding the financing of the subrecipient audits. When it was found to be impractical, because of bidding requirements and other problems, for the prime sponsor to contract with the

CPA firm doing the audit of the prime sponsor for the Department of Labor, we advised them to issue their own Request for Proposals (RFP) and select a firm themselves. Subsequently, an RFP was issued for audits of Youth Pride and Back Alley Theatre, two subgrantees.

On May 6, 1980, the Office of Inspector General (OIG) Philadelphia Regional Audit Manager met with a high level official of the District government, at which time a list of subrecipients for fiscal years 1977, 1978, and 1979 was obtained. However, the list was not prepared in a manner that would provide funding data for individual subrecipients. This information is needed to determine which subrecipients should be audited. It was therefore agreed upon by both parties that a revised list would be compiled by May 13, 1980, and that an RFP would be issued by the first of June. The revised list has not yet been received.

The OIG audit of the District of Columbia prime sponsor began on October 22, 1979. We expect that the final audit report will be released by September 30, 1980. It is now too late for this report to include information from any audits of subrecipients that have

not yet begun. However, we are still working with the District to get the subrecipient audits started. We are prepared to recommend that the Department take all steps necessary to see that this is done, including use of appropriate enforcement authorities contained in the CETA.

At this point, I will address generally, GAO's findings regarding community action organizations and other grantees. We have reviewed the summary workpapers provided us by GAO which were the basis of their testimony before the subcommittee regarding community action organizations. The majority of the findings pertained to the Community Services Administration (CSA) and the Department of Health and Human Services.

First, GAO found instances of grantees making loans from one Federal Grant to another. This presents a series of problems including recordkeeping difficulties and questionable repayment practices. This general problem was found in three DOL funded grantees:

Raleigh County Community Action Association,
Beckley, West Virginia.

Southeastern Tidewater Opportunity Project (STOP),
Norfolk, Virginia.

Central Area Motivation Program (CAMP), Seattle, Washington. The State of West Virginia has had the Raleigh County Community Action Association, a CETA subgrantee, audited through September 30, 1978. The resulting audit reports were forwarded to our Philadelphia Office. Those findings include \$38,945 in questioned costs. The OIG audit of the West Virginia CETA prime sponsor disclosed that of this amount, \$15,831 remained unresolved. In our report, which was issued in October 1979 and which covered the period June 14, 1974 through September 30, 1978 we recommend that if adequate documentation from the subgrantee concerning the allowability of these costs cannot be obtained, these costs should be refunded. In addition, we made a number of recommendations to the prime sponsor for improving the procedures for processing subgrantee audit reports and resolving audit findings.

We are currently negotiating with CSA to have a joint audit conducted of the Southeastern Tidewater Opportunity Project in Norfolk.

The FBI as well as our own investigators have open cases on the Central Area Motivation Program of Seattle.

Our investigators have found that most of the problems in this organization involve CSA funds.

A second problem relates to grantees maintaining cash balances in excess of their immediate needs. The one DOL grantee identified by GAO with this problem is the Department of Human Resources, Chicago, Illinois.

The final problem noted by GAO relating to DOL grantees is the susceptibility to dual reimbursements. This means that salaries, for example, could be chargeable to more than one Federal program, and that a grantee could receive reimbursements in excess of actual costs. Those DOL grantees identified as being susceptible to such excess funding are the Department of Human Resources, Chicago, Illinois, and the Community Economic Development Association (CEDA), Cook County, Illinois.

We have resident auditors in the City of Chicago and Cook County. They have been alerted to the problems involving the Department of Human Resources and CEDA. Subject to other audit priorities, our resident auditors at those locations will review these matters.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or the members of the Subcommittee may have.

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

Reply to the Attention of

JUL 7 1980

Honorable Lawton Chiles
Chairman, Subcommittee on Federal
Spending Practices and Open Government
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

In your letter of June 16, 1980, you asked that I provide answers to two questions. The following is our response.

With respect to your first question, none of the 10 coordinated Federal audits mentioned in my statement on June 5, 1980 have been completed. Thus, we have no experience on which to evaluate whether DOL will have problems accepting single audits completed agencies other than DOL. Nonetheless, we do not foresee any problems accepting audit findings from a single coordinated Federal audit of grantees when we are not the lead audit agency. It is of course important that single audits be conducted in sufficient detail to serve as a tool in identifying potential fraud, abuse and waste in each affected Department's programs.

With respect to your second question regarding our audit of the Washington, D.C. CITA program, the OIG audit underway does not include funds awarded to subrecipients by the District. The District has been slow in responding to our requests to obtain audits of their subrecipients. On June 24, 1980, the Philadelphia Regional Administrator for the Employment and Training Administration, in a hand delivered letter, warned the District that sanctions would be initiated if a Request for Proposal (RFP) for auditing their subrecipients was not issued by July 3, 1980. We have since learned that the District issued an RFP on June 25, 1980. We will continue to monitor the District's progress.

Please do not hesitate to contact me if I can be of further assistance.

Sincerely,

A handwritten signature in dark ink, appearing to read "Ronald Goldstock", is written over the word "Sincerely,".

RONALD GOLDSTOCK
Acting Inspector General

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Prepared Statement by

Shelton Kemp
Inspector General
Florida Department of Labor and Employment Security

Mr. Chairman and Members of the Subcommittee on Federal Spending Practices and Open Government, My name is Shelton Kemp, Inspector General for the Florida Department of Labor and Employment Security. I had hoped to appear before you to discuss three areas of concern to us in Florida on the Comprehensive Employment and Training Act (CETA) Program.

While the entire problem is not a fault of the Federal Government, I feel that certain actions taken by the Congress could improve the CETA program. They are as follows:

(1) We have reviewed a number of CETA contracts granted to profit and non-profit corporations that have been incorporated 30 days or less before the effective date of these contracts which is a clear indication that the records of providing services have not been established and their operating capital are funds they received from their CETA contracts and the services they provide in many cases are duplications of existing programs by other agencies which results in providing jobs to those persons employed by corporations.

If additional CETA grants are not received by some of these corporations, they go out of existence (and there are numerous cases) and we are therefore unable to have anyone available to explain these costs. Those dollars that are questioned then become a debt of the State which means negotiating with the Federal agency in an effort to resolve them.

(2) In reviewing contracts regarding the program, we found that when you take out the verbage and 'buzz' words, you wind up with very little content, which does little if anything for the disadvantaged for which CETA was intended to serve.

The contracts are written in such a way that it is difficult even impossible, to measure the results or the impact that this program has had on the population for which it was intended to serve or the program duplicates existing programs. The flexibility of a subgrantee to modify their contract (program or financial content), is usually an easy vehicle to correct problems that exist resulting from poor management.

(3) The regulations established by the U. S. Department of Labor as it pertains to auditing CETA subgrantees are extremely restrictive in that the U. S. Department of Labor feels that only private auditors are independent to perform these audits. We, on the other hand, feel that the Inspector General's Office or Internal Auditors within an agency, such as our's, that is not responsible to the CETA program or the Director of the program is independent and has the capability of performing an audit not only on the financial aspects of the grant, but also as to the program and the results of the program. These audits would be reviewed by the U. S. Department of Labor in the same manner as they review audits performed by a private auditing firm.

We feel that if the State's agencies were allowed to perform the audits, it would result in hundreds of thousands of dollars in savings in just this State, and could be favorably compared to what the United States Government is trying to enact in having one audit group, whether it is from the U. S. Department of Labor, Health, Education and Welfare, etc. to audit all grants issued to a subgrantee eliminating a constant stream of auditors descending upon the grantees.

In closing, I hope that these few remarks which I have made have been of some benefit to you and the Committee Members. I want to assure you that we in Florida are trying to improve the poor image CETA has received over the past few years.


Shelton Kemp
Inspector General for the
Florida Department of Labor
and Employment Security

June 4, 1980

Senator CHILES. We will recess until the call of the Chair.
[Whereupon, at 1 p.m., the subcommittee was recessed, to reconvene subject to the call of the Chair.]

